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IN THE

Supreme Court of the United States

October Term, 1958

No. 232

MILTON KOBLITZ,

Petitioner,

AGAINST

THE BALTIMORE AND OHIO RAILROAD COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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OCTOBER TERM, 1958

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MILTON KOBLITZ,

Petitioner,

AGAINST

THE BALTIMORE AND OHIO RAILROAD COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Milton Koblitz, on behalf of himself and on behalf of all other owners and holders of The Chicago and Alton Railroad 3% Refunding Mortgage Bonds (hereinafter called Alton Bonds) originally in the face amount of $45,350,000., prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Second Circuit, entered on April 28th, 1959 (pp. 48a-49a).* The judgment affirmed a judgment of the United States District Court for the Southern District of New York which dismissed the complaint on the ground that the action was barred by two judgments in *Rieser, Koblitz, et al.* v. *The Baltimore and Ohio Railroad Company* (hereafter called B. & O.), which the plaintiff and others had previously brought against the same defendant.

* Reference is to pages in the certified record.

Opinions Below

The opinion of the District Court is reported in 164 F. Supp. 367 and appears at page 10 (a) of the certified record. The opinion of the United States Court of Appeals is reported in 266 F. 2d 320. A copy of the opinion is appended to this petition at page 16.

There are also appended to this petition the opinion of Murphy, D.J., in the *Rieser* case at page 18 and the opinion of the United States Court of Appeals affirming the judgment in the *Rieser* case at page 38. The opinion of Murphy, D.J., is reported in 123 F. Supp. 44. The opinion of the United States Court of Appeals is reported in 228 F. 2d 563.

Jurisdiction

The judgment of the United States Court of Appeals for the Second Circuit was entered and dated April 28th, 1959.

Jurisdiction to review this case is found in 28 U. S. C. 1254.

Questions Presented

1. Are the judgments in the action *Rieser, et al.* v. *The Baltimore and Ohio Railroad Company,* a bar to the instant action?

2. Who is injured by the fraudulent diversion of assets by a wholly owned subsidiary to its parent—the wholly owned subsidiary or the subsidiary's creditors?

3. Is the claim of creditors of a wholly owned subsidiary against the parent, to whom the subsidiary fraudulently diverted assets, derivative or direct and independent?

4. If the claim is direct and independent, does a creditor by bringing a derivative action in the right of a subsidiary, which is dismissed, lose his right to bring a direct and independent action against the parent to account for property conveyed to it in fraud of the subsidiary's creditors?

Statement

This action was originally brought in the Supreme Court of the State of New York, in and for the County of New York, and was removed by the defendant to the United States District Court for the Southern District of New York on the ground of diversity of citizenship (pp. 23a-24a).

The plaintiff the owner of $50,000 face amount of Alton Bonds sued on behalf of himself and on behalf of the other owners of Alton Bonds to compel B. & O. to account for property which Alton, its wholly owned subsidiary transferred to it in fraud of Alton's creditors (p. 2a).

The right to bring such an action was expressly granted to the holders of Alton Bonds by the United States District Court for the Northern District of Illinois, Eastern Division, in the reorganization of Alton, pursuant to Section 77 of the Bankruptcy Act (pp. 6a-7a).

In the erroneous belief that the diversion of assets by a wholly owned subsidiary to its parent gave the wholly owned subsidiary a cause of action against the parent, the plaintiffs in the *Rieser* case brought a derivative action in the right of Alton against B. & O.

The complaint in that action was dismissed on defendant's motion for summary judgment on the ground that Alton's alleged claim against B. & O. was barred by the Statute of Limitations and was therefore not available to

the plaintiffs in that action because they were suing in the right of Alton and were seeking to enforce a claim which Alton allegedly had against B. & O. (pp. 41a-42a; 228 F. 2d 563, 565—Appendix to Petition, p. 41).

In his opinion in that case Murphy, D.J., said (123 F. Supp. 44, 46, Appendix to Petition, p. 20):

> "* * * Plaintiffs apparently sue in the capacity of creditors in aid of execution on their debtor's claim against defendant: viz, the Alton's claim for damages due to the alleged mismanagement during the period of defendant's control.
>
> * * * * *
>
> "* * * Defendant's present motion is based entirely on the ground of time limitations and, for the purposes of deciding this motion, the factual allegations of the complaint must be taken as true."

It is the thesis of the plaintiff in the instant suit that the plaintiff in the *Rieser* action selected a remedy which did not lie, namely that the diversion of assets by a wholly owned subsidiary to its parent does not constitute a wrong to the subsidiary but to its creditors and that therefore a derivative action in the right of the subsidiary did not lie.

The instant suit is a direct action and is founded on the basic principle of law that if by the diversion of assets to the parent by the wholly owned subsidiary, the subsidiary is rendered insolvent, the injury is to the creditors of the subsidiary and not to the subsidiary itself. And in such a situation the injury to the creditors is direct—and the creditors may proceed directly against the fraudulent grantee for an accounting for the property fraudulently transferred to it.

And it is the position of the plaintiff that the judgments in the ill advised derivative action are no bar to the present action.

The Facts

The facts as alleged in the two causes of action are in many respects alike. The difference between the two actions is not in the facts themselves, but in the correlation of those facts to the rights and interests of the respective parties.

Each complaint sets forth these facts.

B. & O., on January 7th, 1931, acquired all of the issued and outstanding capital stock of Alton (pp. 3a; 30a);

Between July 18th, 1931 and May 31st, 1947, Alton was the obligor upon $45,350,000. principal amount of The Chicago and Alton Railroad Company 3% Refunding Mortgage Bonds (Alton Bonds) (pp. 2a-3a; 29a);

The plaintiffs in the *Rieser* action and the plaintiff in the instant action are holders of Alton Bonds (pp. 2a-3a; 30a) and the respective actions were brought by them in behalf of themselves and other holders of Alton Bonds (pp. 28a-29a; 2a);

In January 1931, when B. & O. acquired the issued and outstanding stock of Alton, Alton was an integrated railroad with an established good will; it had profitable traffic interchange agreements and arrangements with certain railroads; it maintained profitable business relations with suppliers, firms and corporations who in turn favored Alton with substantial traffic; it had its own solicitation department which concentrated on the promotion of business over its lines and it had a substantial complement of rolling stock and equipment (pp. 3a; 30a-31a);

On November 25th, 1942, Alton filed a petition for reorganization under Section 77 of the Bankruptcy Act, in the United States District Court for the Northern District of Illinois, Eastern Division (pp. 6a; 35a); and

In the reorganization proceeding, the order confirming the plan of reorganization specifically reserved and preserved the rights of owners and holders of Alton Bonds to assert any claim against the defendant. That order was dated May 31st, 1947 (pp. 7a; 37a).

The insolvency which caused the filing of the petition was brought about by certain acts which were committed between January 1931 and November 1942. The difference between the complaints in the two causes of action is in the allegations setting forth the acts and in relating the acts to the injuries and to the rights and remedies of the parties.

The Rieser Complaint (pp. 28a-41a)

That complaint set forth two causes of action. In the first cause, the plaintiff charged that "in violation of its fiduciary duties * * * and using its complete domination and control of Alton * * * the defendant * * * caused loss, damage and injury to Alton, to the holders of Alton Bonds and to the property and assets (of Alton)" (p. 37a).

The complaint then proceeds to enumerate the various wrongs committed by B. & O. against Alton: "The defendant caused traffic * * * to be diverted to defendant's lines (p. 31a); caused Alton to interchange traffic with lines chosen by defendant (p. 31a); the defendant * * * eliminated the traffic solicitation department of Alton * * * to insure preferential treatment * * * at the expense of Alton (whereby) * * * Alton and the holders of Alton

Bonds * * * were damaged in the amount of about $17,500,000 (pp. 31a-32a); defendant used largely its own rolling stock to meet the requirements of Alton and * * * neglected to keep Alton's rolling stock * * * in proper order and repair * * * and permitted said rolling stock to rust and rot * * * [by reason of which] Alton suffered the loss of capital assets * * * in an amount not less than $19,500,000; and of net income in amount of not less than $5,000,000. (p. 32a); defendant used Alton's tracks and equipment * * * without paying Alton the reasonable value [and] * * * caused repairs to be made to its own rolling stock through the facilities of Alton * * * without paying the reasonable value of said use * * * in the amount of about $1,000,000. (pp. 32a-33a); defendant caused diversion of purchases * * * to potential shippers over defendant's lines and thus severely damaged Alton's business relations * * * in the amount of about $3,000,000. (p. 33a); the defendant caused Alton to negotiate new contracts * * * containing terms less favorable to Alton and more favorable to defendant, to the unjust enrichment of the defendant and damage to Alton and holders of Alton Bonds * * * in the amount of about $1,000,000. (p. 33a); during 1940 and 1941, Alton suffered an aggregate net loss of about $2,000,000. [and]; * * * defendant filed federal tax returns * * * upon a consolidated basis [and] if defendant had not forced Alton to include the results of its operations in consolidated returns * * * Alton * * * would have deducted all or most of its losses during the years 1940 and 1941 from its net taxable income for 1942 and 1943 and thereby have saved Federal taxes * * * in an amount unknown to plaintiffs (pp. 33a-34a); [and] the defendant discriminated unfairly against Alton in dividing revenues on traffic interchanged between them" (p. 34a).

In the second cause, the plaintiffs repeated the allegations of the first cause of action and then alleged that "the acts and transactions complained of also constitute a fraud practiced by the defendant upon Alton and the holders of Alton Bonds * * *" (p. 39a).

The complaint in the *Riesey* suit made B. & O. the wrongdoer and Alton the victim. It is the defendant who committed all the acts.

The charge was that B. & O., the sole stockholder, seized control of Alton and compelled Alton against its, Alton's will, to perform and commit the various acts charged therein. It charged B. & O. not only with the appropriation of corporate opportunities and other valuable rights and property, but it charged B. & O. with waste and mismanagement. Alton owned "in excess of 14,000 freight cars, locomotive and passenger cars, as well as incidental equipment, substantially all of which were in good condition and repair * * * (p. 31a) (and B. & O.) neglected to keep Alton's rolling stock, including engines, passenger cars and freight cars in proper order and repair as required by good railroad practice; instead defendant stored such rolling stock on side tracks in the open, subject to the action of the elements and permitted said rolling stock to rust and rot and otherwise deteriorate, and failed to make replacements so that most of it became useless and valueless" (p. 32a).

B. & O. was asked not only to account for income and property diverted to itself, but also to compensate for loss of assets and for income which was lost because of this waste and mismanagement.

Plaintiffs in that case assumed that the acts set forth constituted a wrong against Alton and gave Alton a cause of action against B. & O. and the plaintiffs sought to enforce that cause of action in the right of Alton.

The Koblitz Complaint (pp. 2a-9a)

The Koblitz complaint presents the acts which caused the insolvency and brought about the reorganization proceeding in their true perspective, in a context which realistically sets forth the wrongs and wrongdoers and with proper allegations of facts spells out a direct action against B. & O.

The gist of that complaint is as follows (pp. 3a-4a):

> "SIXTH: That upon acquiring the stock of Alton, as aforesaid, the defendant and Alton entered upon a design, scheme and plan to defraud the creditors of Alton, including plaintiff and other holders of Alton Bonds.
>
> "SEVENTH: Pursuant to said design, plan and scheme, Alton elected as officers and directors of Alton, servants and employees of the defendant and Alton became a part of an instrumentality and agency of the defendant's railroad system.
>
> "EIGHTH: That in furtherance of the plan, scheme and design as aforesaid, the defendant and Alton committed and performed the following acts and deeds."

Then follows a recital of various acts by which corporate opportunities and other valuable rights and property were conveyed and transferred to B. & O. by Alton in fraud of Alton's creditors.

There is no mention of the equipment and rolling stock which was stored "on side tracks in the open"; and permitted "to rust and rot and otherwise deteriorate"; there is no mention of "the loss of capital assets • • • in an amount not less than $19,500,000"; there is no charge of waste or mismanagement.

In fact, there was no mismanagement of Alton. Alton was very well managed, but in the interest of B. & O. its sole stockholder, and to the injury and damage of Alton's creditors, the bondholders.

If Alton had had no creditors, there would have been no grounds for complaint for no one would have been injured.

But Alton did have creditors—bondholders—and those acts injured those bondholders.

In the *Koblitz* action, the wrongdoers are B. & O. and Alton and the injured are the holders of Alton Bonds. There is no charge that B. & O. injured Alton.

The plaintiff charges that B. & O. and Alton entered into a conspiracy to defraud Alton's creditors and the acts complained of were committed pursuant to that conspiracy.

The suit is brought not for the recovery for waste or mismanagement, but for an accounting for corporate opportunities and other valuable rights and property fraudulently conveyed to B. & O., by its wholly owned subsidiary; the fraudulent grantee is asked to account for property fraudulently conveyed to it.

The Judgments in the Rieser Action (pp. 41a, 44a).

The judgments dismissing the complaint in the *Rieser* action were entered upon the defendant's motion for summary judgment on the ground that the alleged action by Alton against B. & O., was barred by the New York Statute of Limitations (Exhibit B, 41a, Exhibit D, 44a) and hence not available to the plaintiffs.

The sufficiency of the complaint was not challenged or considered. The court was not asked to and did not con-

sider whether the facts alleged did in fact spell out a cause of action by Alton against its sole stockholder, B. & O.

There was no trial of the issues—there was no adjudication of the merits. The case was dismissed upon defendant's plea in bar—not on an adjudication of the merits.

The *Rieser* complaint alleged that B. & O. had committed certain wrongs against Alton and that the plaintiffs as judgment-creditors of Alton, were entitled to enforce Alton's claim against B. & O. *And the Court determined merely that if Alton had a cause of action against B. & O., that cause of action was barred by the statute of limitations, and was therefore not available to the plaintiffs.*

Nothing else was considered.

Nothing else was determined.

Reasons for Granting the Writ

I. The decision of the United States Court of Appeals is in direct conflict with the decision of this Court in *Southern Pacific Company* v. *Bogert*, 250 U. S. 483.

The plaintiff in the *Rieser* action chose a derivative action which did not lie and now the lower courts say that the choice of a derivative action which did not lie is a bar to a direct action to compel B. & O. to account for property fraudulently conveyed to it.

Alton had no cause of action against B. & O. Between January 1931 and November 1942, when the various acts which the Rieser complaint charged were wrongs committed by B. & O. against Alton, B. & O. was the sole stockholder of Alton.

A suit by Alton against B. & O. would have been in effect a suit by B. & O. against itself because B. & O. is the sole stockholder and it would be suing itself to recover from itself for wrongs allegedly committed by itself.

The corporation belongs to its stockholders and with respect to acts performed with the unanimous consent of its stockholders, neither the corporation nor its stockholders may sue.

Stockholders by their unanimous consent, may do as they choose with the corporate affairs and assets, provided, however, that what they do is not prohibited by statute, does not contravene public policy and does not affect the rights of creditors.

See *Old Dominion Copper Co.* v. *Lewisohn*, 210 U. S. 206; *McCandless* v. *Furland*, 296 U. S. 140, 162; *Manson* v. *Curtis*, 223 N. Y. 313 (1918); *Clark* v. *Dodge*, 269 N. Y. 410; *Sheldon Hat Blocking Co.* v. *Eickemeyer Hat Blocking Machine Co.*, 90 N. Y. 607; *General Hatters Supply Co.* v. *Hartman*, 148 N. Y. S. 2d 90 (N. Y. Sup. Ct. 1955. Not officially reported.)

The choice of a remedy which did not exist, is no bar to the present action.

The leading case of plaintiffs in search of a remedy is *Southern Pacific Company* v. *Bogert*, 250 U. S. 483.

The action was brought in 1913 to impress a trust upon stock held by Southern Pacific. The transactions which were the basis of the action took place in 1887. Between 1887 and 1913, the plaintiffs pursued suit after suit in search of a proper remedy.

The suit immediately preceding this action was brought in the Supreme Court of the State of New York, New York County; *MacArdell* v. *Olcott*, 189 N. Y. 368 (1907).

The complaint in that case set forth a "'stockholders' action of and for the benefit of the corporation" (379).

The trial court dismissed the complaint for failure to make out a cause of action. The Appellate Division (104 App. Div. 263; 93 N. Y. S. 799) affirmed because the action was "not to impress a lien upon the stock of the Houston Company, which was subsequently acquired by the Southern Pacific Company" (93 N. Y. S. 804).

In the Court of Appeals, plaintiffs abandoned the cause of action alleged. They conceded that no "stockholders' action" existed.

Without amendment of the complaint which had been dismissed and adopting the suggestion of the Appellate Division, the plaintiff proceeded upon a theory of trust. With respect to that, the Court of Appeals said at page 383:

> "In this contention the appellants have abandoned their complaint of fraud and confusion and conspiracy amongst the defendants against the corporation, whereby the latter has been stripped of its property, and inferentially they assume the validity of these steps and transfers as against the corporation because they insist upon sharing with the Southern Pacific Company the advantages which it has secured thereby. In their brief they specifically affirm the validity and binding effect of the judgment of foreclosure and sale and do not dispute that a good and valid title to property was obtained thereunder. In their own words 'The plaintiffs seek—nothing more is necessary for them upon the present appeal—to impress upon the interest of the Southern Pacific Company in the shares of the new company and in the lands a trust obligation to account for profits to its associate stockholders.' "

The Court of Appeals, however, affirmed the judgment of the lower court, because it had "no authority which would permit it to utilize facts introduced under a complaint to sustain one well-defined cause of action as a basis upon appeal for an entirely distinct and different cause of action" (p. 384).

In the *Bogert* case, Southern Pacific Company pleaded the judgment in the *MacArdell* case was a bar to that action. In overruling that contention, Brandeis, J., said at page 490:

> "The minority stockholders sought, when presenting the case in the Court of Appeals of New York (MacArdell v. Alcott, 189 N. Y. 368-372-373) to have declared the trust which was later decreed in this suit; but that Court refused to consider the contention for the reason that this claim to relief was based upon a theory 'widely at variance' with that upon which that action was commenced and tried. Because of such divergence the earlier decrees do not operate as res judicata."

See also *Troxell* v. *D. L. & W. Railroad Co.*, 227 U. S. 434; *Frank Shepard Co.* v. *Zachary P. Taylor Pub. Co.*, 198 App. Div. 638; mod. in other respects in 234 N. Y. 465; *Henry* v. *Hegrington*, 193 N. Y. 218; *Cohen* v. *City Company of New York*, 283 N. Y. 112.

II. Alton Bondholders as part of their distributive share in the reorganization of Alton pursuant to Section 77 of the Bankruptcy Act were granted the right to assert whatever claim they as bondholders had against B. & O.

Recovery has been denied Alton Bondholders because in the first action they chose a remedy which did not lie.

The holders of Alton bonds are thus deprived of rights awarded to them in the reorganization proceedings of Alton.

CONCLUSION

For the reasons stated, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted.

NATHAN B. KOGAN,
of New York, N. Y.
Counsel for Petitioner.

DAVID M. PALLEY,
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Opinion of United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 180—October Term, 1958.

(Argued March 3, 1959 Decided April 28, 1959.)

Docket No. 25331

MILTON S. KOBLITZ,

Plaintiff-Appellant.

AGAINST

THE BALTIMORE AND OHIO RAILROAD COMPANY,

Defendant-Appellee.

Before:

MEDINA and HINCKS, Circuit Judges, and MATHES, District Judge.*

Appeal from a judgment of the United States District Court for the Southern District of New York, Frederick van Pelt Bryan, *Judge.*

Plaintiff appeals from a summary judgment granted against him in an action on behalf of himself and other bondholders of Alton Railroad Company, on the ground

* United States District Judge for the Southern District of California, sitting by designation.

that plaintiff was bound by a prior judgment. (Opinion below is reported at 164 F. Supp. 367. Affirmed.

DAVID M. PALLEY, New York, N. Y. (Nathan B. Kogan and Louis Boehm, New York, N. Y., on the brief), *for plaintiff-appellant.*

JOHN D. CALHOUN, New York, N. Y. (Cravath, Swaine & Moore and John F. Hunt, Jr., New York, N. Y., on the brief), *for defendant-appellee.*

PER CURIAM:

We affirm on the opinion of Judge Bryan, reported at 164 F. Supp. 367. In addition to the estoppel of the former judgment we find that the basic point now argued as to whether the source of appellant's claim is derivative or direct, was determined in the appeal to this Court from the adverse judgment in the prior action. *Rieser* v. *Baltimore & Ohio R. R.*, 2 Cir., 1955, 228 F. 2d 563. Thus appellant is bound not only by a direct but also by a collateral estoppel.

Affirmed.

Opinion of United States District Court in *Rieser* Case

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

M'filmed

Civ. 75-223

NORVIN RIESER, MILTON S. KOBLITZ, GEORGE S. CHAMPLIN, E. M. DART MFG. CO., LILLIAN BOEHM, BERNARD FEIN, KATHRYN P. BRAITHWAITE and EDWARD F. QUIRKE,
Plaintiffs,

— AND —

EMANUEL JOSEPHSON, RUBIN SLAVSKY, RAYMOND WILEY and WILLIAM W. LANGE,
Intervening Plaintiffs,

AGAINST

THE BALTIMORE AND OHIO RAILROAD COMPANY,
Defendant.

APPEARANCES:

LOUIS BOEHM and NATHAN B. KOGAN, Co-General Counsel for the Plaintiffs (Louis Boehm, Victor House, Spencer Pinkham, of Counsel).

Louis H. O. Fischman, Attorney for Intervening Plaintiffs.

Cravath, Swaine & Moore, Attorneys for Defendant (Ralph L. McAfee, George M. Billings, Edward C. Perkins, of Counsel).

Murphy, *D. J.*

This is a motion made by defendant, The Baltimore and Ohio Railroad Company, for summary judgment pursuant to Rule 56(b), Federal Rules of Civil Procedure, 28 U. S. C. A., dismissing the consolidated amended complaint. The motion is made upon the ground that the complaint, and all the claims alleged in it, are barred either by the New York statute of limitations of three years[1] or six years.[2] In the alternative, defendant moves for dismissal of all claims accruing prior to May 7, 1942, as barred in any event by the New York ten-year period of limitations.[3]

The complaint undertakes to state a claim in the nature of a representative class suit by former bondholders of the Alton Railroad Company (hereinafter called the Alton). The gist of the complaint is that, during the period January 7, 1931, through November 25, 1942, when defendant owned and controlled all the voting stock in the Alton, it so mismanaged the affairs of that railroad, while favoring its own interests, as to cause the Alton to become insolvent. Such mismanagement, it is alleged, made necessary a reorganization of the Alton, under Section 77 of the Bankruptcy Act, in which the Alton bondholders realized only $375 for each $1,000 principal amount of bonds. In the reorganization proceeding the claim on the Alton bonds was allowed in the full amount, so that plaintiffs assert that they are judgment creditors whose

1. N. Y. C. P. A. §49.

2. *Id.* §§47-a, 48(8).

3. *Id.* §53.

proven claim has been only partially satisfied. Plaintiffs apparently sue in the capacity of creditors in aid of execution on their debtor's claim against defendant; *viz.*, the Alton's claim for damages due to the alleged mismanagement during the period of defendant's control.

Jurisdiction is alleged on the ground of diversity of citizenship, defendant asserted to be a Maryland corporation, and plaintiffs to be citizens of states other than Maryland.

The complaint sets forth two separately stated claims with material allegations all stated in the first count which seeks damages due to alleged mismanagement of the Alton. The second count repeats the allegations of the first one and alleges that those facts also constituted a fraud upon the Alton and its creditors; that the action is one for fraud within the contemplation of the applicable internal time limitation of New York; and that plaintiffs did not discover the facts constituting such fraud until long after the commencement of certain reorganization proceeding. Defendant in its answer denies any wrongdoing or mismanagement with respect to the Alton and concedes that substantial issues of fact exist on this issue. Defendant's present motion is based entirely on the ground of time limitations and, for the purposes of deciding this motion, the factual allegations of the complaint must be taken as true.

Such allegations are of two sorts: (1) those relating to plaintiffs' rights as bondholders of the Alton; and (2) those relating to the alleged claim against the defendant.

(1) With respect to their rights as bondholders plaintiffs allege that they own bonds of the Alton which were secured by a mortgage constituting a first lien upon all of its assets. In April, 1941, the Alton defaulted in pay-

ment of interest on these bonds, and their entire principal amount then became due. On November 25, 1942, the Alton filed in the United States District Court for the Northern District of Illinois, and that court approved, a petition for reorganization under §77 of the Bankruptcy Act, with order enjoining commencement of suits against the Alton or seizure of or interference with its property. A claim, filed in the reorganization proceeding on behalf of all bondholders by a trustee representing them, was allowed for the full amount of the bonds. Application, made on behalf of creditors in the reorganization proceeding to require the Alton's trustee to prosecute a claim against defendant for alleged mismanagement, or to permit the bondholders to do so was denied, and the injunction already mentioned remained effective until termination of the reorganization proceeding. In May of 1947, a consummation order and final decree was entered in the reorganization proceeding canceling the mortgage securing the Alton bonds and voiding the bond certificates. The Alton bondholders received securities of the purchasing corporation claimed to have had a market value of about $375 for each $1,000 principal amount. In addition, they were permitted to retain the bond certificates perforated with a legend reciting that the subject bond had been canceled for all purposes " * * * except for purpose of evidencing right of the bearer or registered owner to a claim, if any, against The Baltimore and Ohio Railroad Company".

By reason of the foregoing, plaintiffs allege that they, and all other bondholders similarly situated, stand in the position of judgment creditors who have issued executions which have been satisfied to the extent of 37 cents on the dollar, and whose debtor, the Alton, has no other assets.

(2) With respect to their claim against defendant, plaintiffs allege that on January 7, 1931, defendant acquired

all the voting stock of the Alton, and thereafter elected all its officers and directors. These are claimed to have acted as defendant's servants and in accordance with its directions and policies. Defendant's control of the Alton continued until November 25, 1942, when the Alton went into reorganization. During the period of its control, defendant is charged with having diverted revenue-bearing traffic from the Alton's lines to its own, and revenue-bearing interchange traffic from railroads with which the Alton had profitable business relations to railroads with which defendant had profitable business relations, thereby enriching defendant and damaging the Alton and its bondholders in the amount of $17,500,000.

Plaintiffs claim that defendant during this period failed to keep the Alton's rolling stock in repair, stored it on open side tracks where it became valueless. As a result the rolling stock is asserted to have been damaged to the extent of $19,500,000, and the Alton said to have lost an additional $5,000,000 which it would have earned as profits from its use.

Defendant is further charged during this time to have used the Alton's tracks, equipment and facilities without paying for such use, and having caused the Alton to repair defendant's rolling stock free of charge. Resulting damage to the Alton is claimed to have been $1,000,000.

Defendant is also claimed at this time to have diverted purchases of company equipment and supplies from potential shippers over the Alton's lines to potential shippers over the defendant's lines, thereby enriching defendant and damaging the Alton and its bondholders in the amount of about $3,000,000.

Plaintiffs say also that defendant within the period of their control caused the Alton to negotiate new contracts with three designated companies upon terms less

favorable to the Alton and more favorable to defendant, thereby enriching defendant and damaging the Alton and its bondholders in the amount of about $1,000,000.

It is claimed that defendant filed income tax returns in respect of the Alton's operations and its own for the years 1940 and 1941 upon a consolidated basis. During those years the Alton suffered a net operating loss of about $2,000,000 which defendant charged against its own profits for those years. Such losses could have been set off against profits said to have been made by the Alton during 1942 and 1943, with a consequent income tax saving to the Alton. That saving was lost to the Alton. In addition defendant is said to have discriminated against the Alton in dividing revenues derived from traffic interchanged between them, retaining an excessive proportion during its control.

Finally, defendant is charged with having deprived the Alton, by all of the foregoing acts, of its opportunity to improve its competitive position, thereby preventing it from capitalizing on its opportunities and from earning substantial net returns; and with having practiced, by all the foregoing acts, a fraud upon the Alton and upon the Alton bondholders, including plaintiffs.

The complaint seeks appointment of a receiver, judgment against defendant in the amount of at least $28,343,753, payment of plaintiffs' expenses, and distribution of the balance among Alton's bondholders.

In respect of time limitations, the answer sets up the three, six and ten-year periods under New York statutes as well as the five-year period under the Illinois statute.

The common law conflict-of-laws rule regarded the ordinary statute of limitations as procedural and consequently required choice as governing law of the forum's

own period of limitation to the exclusion of any other.[4] The civil law of the continental courts has generally taken the contrary view that time limitations are substantive and accordingly require application of the period prescribed by the law of the place of the transaction rather than that of the forum. Some American cases have favored this view as more harmonious with factors significant for choice of governing law in a conflicts situation.[5] In New York the legislature early undertook to overrule the common law conflicts rule by adoption of a "borrowing" statute of limitations which made governing the internal period of limitation of the state of which the defendant was a resident at the time the action accrued.[6] Through a series of amendments,[7] this statute has evolved into its present form as a rule of alternate reference: for a cause of action which arises outside the forum either the time limitation of the forum or that of the state where the cause of action arose, is applicable in the case of non-resident plaintiffs, and only the time limitation of the forum in the case of resident plaintiffs. All plaintiffs must surmount the hurdle of the internal period of New York; non-resident plaintiffs must in addition surmount the hurdle of the period prescribed by the state where the cause of action arose. The *Erie* principle, controlling cases like the instant one where jurisdiction is based on diverse citizenship, requires application in this court of

4. Restatement, Conflict of Laws §§603, 604 (1934).

5. See *LeRoy* v. *Crowninshield*, C. C., D. Mass. 1820, 15 Fed. Cas. No. 8, 269, page 362, 2 Mason 151; *Davis* v. *Mills*, 194 U. S. 451 at 454.

6. Cf. *Miller* v. *Brenham*, 68 N. Y. 83 with N. Y. Code of Civil Procedure §390, effective May 1, 1877.

7. Code of Civil Procedure §390a, added by N. Y. Laws, 1902, c. 193; Civil Practice Act §13; N. Y. Laws 1943, c. 516.

this statutory conflicts rule of choice of law as a constitutional mandate.[8]

Plaintiffs consist of a Rhode Island corporation, individual citizens of California and Rhode Island, and five residents of New York. With respect to the New York residents, only the internal period of New York is applicable; for the others, the New York time-limitation, and, in addition, that of the state where the cause of action accrued, govern.

At the outset there are several problems: characterization of plaintiffs' claim; and determination whether or not under any applicable period of limitation the appropriately classified claim is barred. With respect to the second question, there are additional issues: when does the applicable time limitation begin to run; and which one of several varying periods governs. Each separate problem does not merely add to the number of possible resolutions; it multiplies them. When it is realized that no single answer to any question is urged by either side, the magnitude of the geometric progression of possible solutions is manifest. For example, defendant contends that the claim may be viewed in three different perspectives: (1) as one by the bondholders against the Alton itself, forming the basis for a creditor's bill in equity against defendant; (2) as a claim of the Alton against defendant which they, as creditors, pursue by way of such a creditor's bill; and (3) as a claim by plaintiffs directly against defendant for an injury done to their security as bondholders.

Moreover, under defendant's first classification, alternate statutes of limitations are alleged to apply: one of

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8. *Erie Ry. Co.* v. *Tompkins*, 304 U. S. 64; *Klaxon Co.* v. *Stentor Electric Mfg. Co.*, 313 U. S. 487; *Guaranty Trust Co.* v. *York*, 326 U. S. 99.

six years relating to actions on bonds secured by a mortgage on real estate,[9] or another of similiar duration governing actions upon contract obligations.[10] Under defendant's second qualification of the claim, it is urged that two additional periods of limitations in the alternative govern: the three year statute applicable to actions to recover damages for injury to property;[11] or a six year one for actions by a corporation against a former shareholder.[12] Defendant's third characterization would bar so much of the claim relating to acts prior to May 6, 1942, under still another limitation, the ten year equity statute.[13]

For their part plaintiffs insist that their claim is an "old-fashioned creditor's suit recognized by Courts of Equity almost from the beginning of equity jurisprudence." No statute of limitations, they argue, can begin to run until judgment on plaintiffs' claims in the bankruptcy proceeding on May 31, 1947, less than five years before commencement of the present action. Moreover, plaintiffs contend that no period of limitation shorter than six years is applicable, and actually the ten year equity statute running from 1947 is most appropriate.

The first major problem is the characterization, classification or qualification of plaintiffs' claim for purposes of time limitation. The juridical nature of plaintiffs' claim must be ascertained. Such characterization must be made under the *Erie* principle in accordance with the body of law in the conflicts area of the state in which this court sits. There is no indication that such classification

9. N. Y. C. P. A. §47-a.

10. *Id.* §48(1).

11. *Id.* §49(7).

12. *Id.* §48(8).

13. *Id.* §53.

varies between the body of law for conflict and that for internal purposes in New York. Accordingly, the qualification of plaintiffs' claim must proceed largely on decisional law in New York in non-conflict situations.

Two crucial questions are presented in the instant case: (I)-From what time does *any* applicable period of limitation begin to run—from the date of default by Alton on plaintiffs' bonds in April 1941, from the time when defendant ceased control of Alton in November, 1942, or from the day the final order in the bankruptcy proceedings was entered in May, 1947; (II) What period of limitations governs—a three, one of several six year periods, a ten or even a twenty year one. This question also involves consideration whether such period is tolled during the reorganization proceedings.

I

Viewing plaintiffs' claim as one asserted as an asset of their debtor, Alton, which they may be entitled to enforce in a creditor's action in aid of some execution only partially satisfied in the bankruptcy proceedings, the question presented is whether any period of limitation applicable begins to run from April, 1941, or November 25, 1942, at which times plaintiff's claim against Alton had clearly accrued, on one hand, or from May 31, 1947, when the final order in the bankruptcy proceedings was entered, on the other hand.

Two cases in point decided five years apart by the same court offer conflicting answers and require some detailed consideration. The first, Buttles v. Smith,[14] in 1939, was an action brought by a receiver, in February, 1938, as ancillary to sequestration proceedings on behalf of cred-

14. 281 N. Y. 226.

itors of an insolvent corporation. The receivership proceedings had been instituted by one Anness in aid of execution on a judgment entered in 1933 which in turn had arisen out of an obligation incurred in 1926. The basis of the action was a series of alleged wrongful transfers alleged to have taken place in 1927 and 1929.

The complaint stated three separate causes of action, each to set aside alleged fraudulent diversions of corporate funds and for an accounting from defendants of property received by them. The claims were all statutory, under (1) §15, New York Stock Corporation Law (prohibiting transfers in contemplation of insolvency and making participating officers and directors personally liable to creditors to the extent of their direct loss); (2) §274, New York Debtor and Creditor Law (declaring fraudulent transfers making working capital inadequate for a specific business or transaction, as to persons becoming creditors during such business or transaction); and (3) §60(5), New York General Corporation Law (giving to creditors a right of action to set aside transfers made, with knowledge of the transferee, in violation of any law).

As to all three causes of action, the court held that the claim was one for an accounting in equity and not at law for damages, since it was one by a creditor attempting to follow funds of the corporation into the hands of persons to whom illegally transferred, and that the ten-year statute of limitations applied to plaintiff's claim.

As to accrual of the causes of action, the court differentiated the first and third from the second, holding that the second accrued at the time of the wrongful transfers, more than ten years prior to the beginning of suit, and was accordingly barred. The other two causes of action, it ruled, accrued only when judgment had been obtained by Anness and execution had been returned unsatisfied.

Since this event was less than six years from the date of suit, it held those two causes of action not to be barred, either by the six-year or the ten-year statutes.

In the second case, Hastings v. H. M. Byllesby & Co., et al.,[15] suit was brought in 1939 by a special trustee in bankruptcy procedings to recover from defendant property of the debtor allegedly wasted or taken unlawfully from it, and to recover profits allegedly wrongfully appropriated. The complaint alleged that defendant Haystone conspired in June, 1925, to obtain large profits at the expense of the debtor corporation by means of transactions in which defendant received from the debtor valuable stock and large sums of money in exchange for property worth much less. These transactions took place in 1926. The debtor's petition in bankruptcy was filed in 1935.

The court affirmed the order of an intermediate appellate tribunal barring the action under the six-year statute of limitation running from March, 1926. The court distinguished the Buttles case on which plaintiff relied for his contention that the cause of action accrued upon his appointment as trustee in 1935, and not at the time of the alleged wrongful acts, in these terms:

> "The plaintiff relies heavily upon our decision in *Buttles* v. *Smith*, 281 N. Y. 226. In that case we held that no cause of action to set aside transfers of corporate property made in violation of section 15 of the Stock Corporation Law or of subdivision 5 of section 60 of the General Corporation Law accrues to a creditor until the creditor has obtained a judgment and execution has been returned unsatisfied. The Statute of Limitations, we there said, does not commence to run against such a cause of

15. 293 N. Y. 404.

action, asserted by a receiver appointed in a suit brought by a judgment creditor in aid of execution, until the cause of action accrues to the creditor. The gist of the creditor's cause of action, asserted in that case by a receiver appointed in an action brought by the judgment creditor for the sequestration of the property of a corporate debtor, was the illegal transfer of corporate assets which otherwise would have been available for the satisfaction of a judgment obtained by the creditor. No wrong is done by such a transfer to a creditor whose debt can be satisfied out of other assets of the debtor, and ordinarily a creditor may appeal to the courts to set aside an illegal transfer of the debtor only after he has obtained a judgment which he has been unable to enforce by execution. The wrong to the creditor by such a transfer of corporate assets is independent and distinct from any wrong to the corporate debtor, and in *Buttles* v. *Smith*, supra, the receiver, suing in behalf of a creditor, sought a remedy solely for the wrong done to the creditor. No wrong to the debtor was alleged in the complaint."[16]

Again with respect to plaintiff's claim "that here the trustee in bankruptcy is clothed with all the rights of a creditor with execution returned unsatisfied and is asserting in behalf of creditors a cause of action for the relief specified in subdivisions 1 and 2 of Section 60 [of the General Corporation Law], just as in *Buttles* v. *Smith* the receiver asserted a cause of action in behalf of a creditor for the relief specified in subdivision 5 of the same section, and that the same rules fixing the time when the cause of action accrues and the statutory limita-

16. 293 N. Y. at 410-411.

tion begins to run must be applied to all actions brought in behalf of a creditor or creditors pursuant to the provisions of sections 60 and 61 of the General Corporation Law", the court assumed *arguendo* that such was the case, but observed:

> "Even so the fact remains that the cause of action is based upon a wrong to the debtor. The cause of action accrued to the debtor when the wrong occurred and though the statute permits a creditor or stockholder to bring an action for the wrong done to the corporation, the damage or injury to a creditor, like the damage or injury to a stockholder, arises only indirectly from the damage or injury to the corporation and is repaired when the damage or injury to the corporation is repaired. That, as we have pointed out, was not true of the cause of action asserted in *Buttles* v. *Smith*, 281 N. Y. 226, *supra*, under a different subdivision of the same section of the statute. The reasons which in that case required the conclusion that the cause of action there asserted accrued when execution was returned unsatisfied do not apply here—or perhaps even point to a different conclusion."[17]

It may be seriously questioned whether in fact the Buttles case represents a "wrong to the creditor • • • independent and distinct from any wrong to the corporate debtor," in contradistinction to the claim in the Hastings case which "arises only indirectly from the damage or injury to the corporation and is repaired when the damage or injury to the corporation is repaired". Both claims may well have stood on the same ground so far as their derivative or independent nature is involved. If so, then the Hastings case may not be distinguishable but may

17. *Id.* at 411.

have overruled *pro tanto* the Buttles case. Yet if the varying result is explicable by comparative scrutiny of the precise language of the pleadings in the respective cases, and "no wrong to the debtor was alleged in the complaint" of the Buttles case, then that distinction controls in the instant situation. The language of this complaint indicates plaintiffs are asserting, not a claim of their own, but one which is an asset of their debtor Alton. For example, plaintiffs allege in paragraph 16 that they:

> "* * * are in the position of creditors who have secured judgment establishing their claims and have issued executions which have been satisfied to the extent of 37½ cents in respect of each dollar of principal amount and otherwise returned unsatisfied."

And in paragraph 17 they allege:

> "The claim asserted against the defendant in this action constitutes the only asset on which the unsatisfied claims of the holders of Alton Bonds may be satisfied."

Under either view of the Hastings case, whatever period of limitation is applicable to plaintiffs' claim, considered as a creditors' suit pursuing their debtor's assets, it must begin to run not later than November 25, 1942, the last possible date of accrual of any claim of the debtor against defendant.

If, however, it is possible to characterize plaintiffs' claim as one against the debtor corporation for a deficiency on the bonds, then it is clear that such claim accrued in April, 1941, the date of default.[18] Or should the claim be classi-

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18. N. Y. C. P. A. §47-a; *State of Rio de Janeiro* v. *Rollins & Sons*, 299 N. Y. 363.

fied as one directly against defendant for injury done to plaintiffs' security under the mortgage securing the bonds, then the date of accrual would again be no later than November 25, 1942.[19]

It does not seem likely that the instant suit is one based upon a final order or decree rendered in the bankruptcy proceedings by the federal district court in Illinois in May, 1947. Even though under such order plaintiffs' claims as bondholders were allowed in full, they were not merged into judgment for the amount of the deficiency. Were such the case, a 20 year period[20] running from date of such order would be applicable, something not urged by plaintiffs. So far from merging plaintiffs' claims as bondholders, the order preserved such claims for pursuit by plaintiffs against their debtor's asset with respect to defendant. So far as such order relates to the deficiency, no mandate or execution could issue thereon, and this is a consideration of controlling importance in determining that this is not a suit upon a judgment of another court.[21]

Another characterization, *viz.*, that of an "action to procure a judgment on the ground of fraud", would change the date of accrual "until the discovery by the plaintiff, or the person under whom he claims, of the facts constituting the fraud."[22] In the second count of their complaint, plaintiffs allege that the "acts and transactions complained of also constitute a fraud practiced by the defendant upon Alton and the holders of Alton Bonds,

19. N. Y. C. P. A. §§49(7), 48; *Schmidt* v. *Merchants Despatch Trans. Co.*, 270 N. Y. 287; *Pollack* v. *Warner Bro. Pictures, Inc.*, 266 App. Div. 118.

20. N. Y. C. P. A. §44.

21. See *Seaman* v. *Clarke*, 60 App. Div. 416.

22. N. Y. C. P. A. §48(5).

including the plaintiffs" and the "facts constituting said fraud were not discovered by the plaintiffs or any of them until long after the institution of the Reorganization Proceeding".

Such "allegations of the complaint" may well be "mere conclusions and even if accepted as allegations of fact they are only incidental to the cause of action brought against defendants on the ground that they have disregarded their duty to the corporation. Such allegations do not constitute a cause of action 'to procure a judgment on the ground of fraud' * * * under the provisions of section 48, subdivision 5, of the Civil Practice Act, * * * ".[23] Moreover, there is no indication that proof of the fraud which is merely alleged as such without more, would be essential to plaintiffs' right to recover,[24] or that the fraud thus alleged is merely constructive rather than in the nature of the common law action of deceit,[25] or that the circumstances were not "such as to suggest to a person of ordinary intelligence the probability that he had been defrauded" during the period of defendant's control of Alton.[26]

Accordingly, whatever period of limitation is governing, it does not appear to commence later than November 25, 1942, when defendant's control of Alton ceased.

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23. *Hastings* v. *H. M. Byllesby & Co. et al.*, 293 N. Y. 404 at 411-412.

24. *Laird* v. *United Shipyards*, 2 Cir., 165 F. 2d 12, cert. denied, 332 U. S. 842; *Saultz* v. *Manufacturers & Traders Trust Co.*, *id.*, 128 *id.* 889, cert. denied, 317 U. S. 674; *Pitcher* v. *Sutton*, 238 App. Div. 291, affirmed, 264 N. Y. 638.

25. *Austrian* v. *Williams*, 2 Cir., 198 F. 2d 697, cert. denied, 344 U. S. 909.

26. *Higgins* v. *Crouse*, 147 N. Y. 411 at 416; *Warner* v. *Republic Steel Corp.*, D. C. S. D. N. Y., 105 F. Supp. 998 at 1009.

II

The second question of what particular period is applicable involves also the consideration whether such period is tolled by the pendency of reorganization proceedings between 1942 and 1947. As the New York court observed, per Lehman, J., in *Schmidt* v. *Merchants Despatch Transp. Co.*,[27] "A single wrongful act which is asserted as the basis of recovery may constitute the breach of a number of obligations of diverse nature and origin. Then it may rest with the plaintiff whether he will assert as the basis of his right to damages the breach of one or more of such obligations; and the single right to recover such damages may then be alleged in different forms, each asserting as a basis of liability the breach of some duty or obligation. Each so-called 'separate and distinct cause of action' becomes in effect a 'count' in the allegation of a single wrong; and whether the statute [of limitations] bars recovery under any count depends upon the nature and origin of the liability asserted in that count."

The troublesome dilemma yet remains: whether a claim is barred if its "very gist and essence",[28] or its "real gravamen",[29] is beyond the longest period, or whether, on the other hand, every conceivable characterization of the claim must be barred.[30]

Suggestive analogies are urged by defendant for application of statutes running from November 25, 1942, providing a three-year period for waste or injury to property,[31] or six-year periods for damages based on con-

27. 270 N. Y. 287 at 299.

28. 270 N. Y. at 300.

29. *Corash* v. *Texas Co.*, 264 App. Div. 292.

30. See *Warner* v. *Republic Steel Corp.*, D. C. S. D. N. Y., 105 F. Supp. 998.

31. N. Y. C. P. A. §§48(8), 49(7); *Coane* v. *American Distilling Co.*, 298 N. Y. 197; *Gottfried* v. *Gottfried*, 269 App. Div. 292; *Corash* v. *Texas Co.*, 264 App. Div. 292; *Austin* v. *Gardner*, 267 App. Div. 865.

tract, injury to property or other common law liability.[32] Yet while claims might have been asserted under section 15 of the Stock Corporation Law or section 60(5) of the General Corporation Law, plaintiffs explicitly disclaim their applicability to the complaint. This has more than ordinary significance, since in *Battles* v. *Smith*,[33] relied upon by plaintiffs, it was to precisely such statutory actions that the six-year period of limitations was made to run only from the date of unsatisfied execution and not that of the original wrongful act. Assuming that available remedies at law cannot be patterned to embrace all the ramifications of the complaint, the ten-year equity statute would be applicable running from the time of the acts and transactions complained of.[34] This assumption is supported by the allegations of fraud, albeit constructive and presumably equitable, in the second count of the complaint.

Remaining is the matter of suspension of such ten-year period. We have already pointed out that the fraud allegation would not shift the commencement of running beyond November, 1942. Nor would the allegation that defendant dominated the Alton until November, 1942, have any different effect.[35] In a number of statutory provisions explicitly dealing with suspension,[36] only one appears in point, *viz.*, "Where the commencement of an

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32. N. Y. C. P. A. §48(1), (7) and (8). See *Potter* v. *Walker*, 276 N. Y. 15; *Dunlop Sons Inc.* v. *Spurr*, 285 N. Y. 333.

33. *Supra* note 15.

34. N. Y. C. P. A. §53.

35. *Pollack* v. *Warner Bros. Pictures, Inc.*, 266 App. Div. 118; *Austrian* v. *Williams*, 2 Cir., 198 F. 2d 697, cert. denied, 344 U. S. 909.

36. N. Y. C. P. A. §17 to 27.

action has been stayed by injunction or other order of a court or judge."[37] The terms of the restraining order, entered by the district court in the reorganization proceedings, alleged in paragraph 8 of the complaint, enjoins interference with "assets * * * choses in action * * * belonging to, or in the possession of the Debtor, * * * or from continuing any pending suits against the Debtor, or from bringing any new suits or proceedings against the Debtor on causes of action accruing prior to this date in or before any Court * * *."

The instant claim although asserting "causes of action accruing prior to" the date of the order, is not one "against the debtor," and consequently outside the ambit of such order. It is questionable whether assertion of the present claim by plaintiffs against the defendant herein during pendency of the reorganization proceedings would have amounted to interference with "assets" or "choses in action" of Alton within the contemplation of the order. But if it did, it is clear that "the commencement of an action" identical with the instant claim by either the Alton or its trustee was not enjoined. It is clear that it is the enforceability of the right sued upon, and not the party asserting such right, which determines the period during which the statute of limitations continues to run.[38]

The instant suit was commenced on May 7, 1952. Accordingly, that part of plaintiffs' claim based upon acts and transactions which occurred more than ten years before the date of commencement of this action are barred.

Motion for summary judgment granted in part.

Judgment accordingly.

Dated, New York, N. Y., June 30, 1954.

THOS. F. MURPHY,
U. S. D. J.

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37. *Id.* §24.

38. See *Bucklin* v. *Bucklin*, 1 Abb. Ct. App. Dec. 242 at 251; *Peters* v. *Delaplaine*, 49 N. Y. 362, at 368; *Cooley* v. *Lobdell*, 153 N. Y. 596, at 602-603; *Mason* v. *Henry*, 152 N. Y. 529; *Hastings* v. *H. M. Byllesby & Co. et al.*, 293 N. Y. 404.

Opinion of United States Court of Appeals in *Rieser* Case

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 13, October Term, 1955.

(Argued October 11, 12, 1955

Decided December 2, 1955.)

Docket No. 23560

NORVIN RIESER, MILTON S. KOBLITZ, GEORGE S. CHAMPLIN, E. M. DART MFG. CO., LILLIAN BOEHM, BERNARD FEIN, KATHRYN P. BRAITHWAITE and EDWARD F. QUIRKE,
Plaintiffs-Appellants.

AND

EMANUEL JOSEPHSON, RUBIN SLAVSKY, RAYMOND WILEY and WILLIAM W. LANGE,
Intervening Plaintiffs-Appellants,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY,
Defendant-Appellee.

Before:

FRANK, HINCKS and WATERMAN,
Circuit Judges.

Appeal from a summary judgment of the United States District Court for the Southern District of New York, entered by Judge Murphy. Affirmed.

LOUIS BOEHM AND NATHAN B. KOGAN (Victor House, Abraham K. Weber, and Spencer Pinkham, of counsel) *for appellants.*

ABRAHAM K. WEBER *for Kathryn P. Braithwaite and Edward F. Quirke.*

LOUIS H. O. FISCHMAN *for intervening appellants.*

CRAVATH, SWAINE & MOORE (Ralph L. McAfee, George M. Billings and Edward C. Perkins, of counsel) for appellee.

FRANK, Circuit Judge:

The facts are fully stated in Judge Murphy's opinion, 123 F. Supp. 44.

1. In their brief filed in this court, plaintiffs say that their suit is but an "old-fashioned creditors' bill" by "creditors of a corporate principal debtor against its sole stockholder for violation of its fiduciary duties as such stockholder," and that this suit, substantively, rests on no New York statute. If, then, the basis of the plaintiffs' suit is non-statutory, we need not consider two cases, much discussed by the parties, *Buttles* v. *Smith*, 281 N. Y. 226, and *Hastings* v. *Byllesby*, 293 N. Y. 404, as both those cases involved the application of the New York statute of limitations to claims based, substantively, on one or more New York statutes.[1]

2. A judgment-creditor, with execution returned unsatisfied, may, without relying on a statute, by an "old-fashioned" creditors' bill, have an equitable levy on an available asset of his debtor. The asset may consist of a

1. Assuming, *arguendo*, that the *Byllesby* and *Buttles* cases were applicable, we think that the instant case is analogous to *Byllesby* rather than *Buttles*, and that the plaintiffs would therefore be barred under the rationale of the *Byllesby* case.

claim against a third person for a wrong that person did to the debtor. If that wrong be regarded as also done to the creditor, it is only an indirect wrong, and the creditor's suit is derivative, in effect.

However, plaintiffs contend that they suffered a direct and independent injury, apart from that done to Alton, and that a cause of action based on such injury accrued only after they had obtained a judgment with execution thereon returned unsatisfied.[1a] The crucial question here is whether the alleged acts of B & O (a) constitute harms to Alton, and but indirectly to plaintiffs, Alton's bondholders, and or (b) constitute harms done directly to those bondholders. Absent a statute, we think they clearly came within the first category.

Alton, for these harms, could have held B & O liable; and so could Alton's bankruptcy trustee, as Alton's successor.[1b] Like the trustee, the plaintiffs stand in Alton's shoes; they have no shoes of their own. Significantly, plaintiffs cite no case holding otherwise, absent a statute.

True, while it remained under the domination of B & O, its sole stockholder, Alton, in practical terms, as virtually B & O's slave, could not have brought suit against B & O. But, under the New York statute of limitations as construed by the New York courts, the period of that domination did not suspend the running of the statute. See *Austrian* v. *Williams*, 198 F. (2d) 697 (C. A. 2); *Laird* v. *United Shipyards*, 163 F. (2d) 12 (C. A. 2).[2]

1a. We assume, *arguendo*, that conceivably there might be facts (other than those here) giving rise to such an independent cause of action, even in the absence of a statute, which the creditors could not pursue until they obtained a judgment and execution thereon was returned unsatisfied.

1b. Cf. *Henderson* v. *Blakley Coal Co.*, 74 F. (2d) 567 (C. A. 2); *Austrian* v. *Williams*, 198 F. (2d) 697 (C. A. 2).

2. This interpretation, out of line with the interpretation of similar statutes in many other jurisdictions, seems harsh and inequitable. But, of course, we must abide by what the New York courts say its statutes mean.

3. Since plaintiffs do not allege any fraudulent conveyance, the New York Debtor and Creditor Law—which dispenses with a judgment in such circumstances—does not apply. Therefore a suit of this kind, an old-fashioned creditor's suit, could not be maintained until plaintiffs had the equivalent of a judgment against Alton and an unsatisfied execution. Plaintiffs maintain, and we shall assume, that they first occupied that position on May 31, 1947, when the Alton bankruptcy proceedings terminated.[3] The statute of limitations, Section 53 of the New York Civil Practice Act, applicable to such an equitable action, fixes a ten-year period within which suit must be brought; and this suit began on May 7, 1952, within that ten-year period.

These facts, however, do not help plaintiffs. We shall assume that, within the ten years ending May 31, 1957, plaintiffs, by their suit, could levy an equitable execution on any of Alton's available assets, which the final decree in the Alton bankruptcy proceedings permitted plaintiffs to pursue. But, to succeed, plaintiffs must show that those assets on which they seek thus to levy—*i.e.*, Alton's claims against B & O—were available when the suit began in 1952. They were not then available, because, before 1952, the statute of limitations had run with respect to those claims.[4] For the pertinent period of limitations is either (a) three years, under the New York Civil Practice Act,

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3. That is, they obtained equivalent of a judgment on the allowance of their bondholder claims in the Alton bankruptcy proceedings; and the termination of those proceedings on May 31, 1947, with part of the amounts due thereon unpaid, was the equivalent of a return of execution unsatisfied.

4. Our reasoning here differs from that of the district judge. But, in affirming a judgment, of course we may do so for reasons other than those of the court below.

Section 49 subdivision 7,[5] or (b) six years, under Section 48 subdivisions (1) or (8).[6]

In short, making assumptions most generous to plaintiffs, suit on the claims against B & O were barred on November 25, 1948, *i.e.*, six years from the appointment of Alton's bankruptcy trustee on November 25, 1942.

4. To be sure, the trustee was discharged on May 31, 1947. We shall assume that—thanks to the provision of the final decree in the Alton bankruptcy proceedings which gave the bondholders the right to pursue the claims, if any, against B & O—plaintiffs succeeded to Alton's right to sue B & O which had never been availed of by Alton's trustee. If so, on the most generous assumptions, plaintiffs' suit would not have been barred until November 25, 1948. But plaintiffs did not start suit until 1952.

We cannot accept plaintiffs' contention that the statute commences to run anew when a claim passes to an assignee of, or a successor to, one who could have sued thereon.[7] An assignment, whether or not by "operation of law," has no such resurrective or phoenix-like potency.[7] Nor, since

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5. Section 49 subdivision 7 includes "an action to recover damages for an injury to property. * * *"

6. Section 48 subdivision 1 includes an action upon a contract, express or implied, except a judgment and other exceptions not here relevant.

Section 48 subdivision 8 includes derivative actions against present and former directors, officers and stockholders for an accounting, for fraud, or to recover penalties or forfeitures imposed by statute or common law, but specifically excludes actions for waste or injury to property or for an accounting in connection therewith. For these latter actions, reference is made to Section 49 subdivision 7.

7. *Bucklin* v. *Bucklin*, 1 Abb. Ct. App. Dec. 242, 251; *Cooley* v. *Lobdell*, 153 N. Y. 596, 602-603.

Section 14 of the New York Civil Practice Act makes a specific exception of an action by a principal against his agent, an exception not relevant here.

Alton's trustee in bankruptcy could have asserted these claims, did the pendency of the bankruptcy proceedings toll the statute, since 11 U. S. C. Section 205(b)—which provides that "the running of all statutes of limitations shall be suspended"—has no application to a suit by a bankruptcy trustee. We think 11 U. S. C. Section 29(e) is applicable to railroad reorganization proceedings and carries the only suspension of statutes of limitation running against claims belonging to the debtor's estate.

5. The New York Civil Practice Act, Section 48(5) provides a six-year period of limitations as to actions for fraud, a period which begins to run only from the discovery of the fraud. Plaintiffs, however, do not allege Alton was a victim of the kind of fraud covered by that section as construed in the New York decisions. See *Austrian* v. *Williams*, *supra*; *Laird* v. *Shipyards*, *supra*, and New York decisions there cited.[8]

Affirmed.

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8. Even if that statute applied to the fraud here alleged, nevertheless the action would fail. For the discovery—of whatever fraud had been practiced by B & O—occurred on November 25, 1942, the date of the appointment of Alton's bankruptcy trustee.

Judgment

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty eighth day of April, one thousand nine hundred and fifty nine.

Present:

HON. HAROLD R. MEDINA,
HON. CARROLL C. HINCKS,
Circuit Judges

HON. WILLIAM C. MATHES,
District Judge

MILTON S. KOBLITZ,
Plaintiff-Appellant

v.

THE BALTIMORE & OHIO RAILROAD CO.,
Defendant-Appellee

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed.

A. DANIEL FUSARO,
Clerk

FILE COPY

Office Supreme Court, U.S.
AUG 14 1959
JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 232

MILTON KOBLITZ,

Petitioner,

—against—

THE BALTIMORE AND OHIO RAILROAD COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

JOHN D. CALHOUN,
Counsel for Respondent,
15 Broad Street,
New York 5, N. Y.

JOHN F. HUNT, JR.,
Of Counsel.

August 14, 1959.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

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—*against*—
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Respondent.

No. 232

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

Opinions Below

The opinion of the district court (R. 10(a)) is reported at 164 F. Supp. 367. The *per curiam* opinion of the court of appeals (R. 49a; Pet. 16) is reported at 266 F. 2d 320.

Jurisdiction

The judgment of the court of appeals (R. 50a; Pet. 44) was entered April 28, 1959. The petition for certiorari was filed July 15, 1959. Petitioner invokes the jurisdiction of this Court under 28 U. S. C. § 1254(1).

Question Presented

Whether under the law of the State of New York the claim of petitioner against respondent is barred by the doctrine of res judicata.

Statement

On May 7, 1952, one Rieser and others, together with petitioner (Koblitz), invoking diversity jurisdiction, filed a complaint against respondent (B&O) in the United States District Court for the Southern District of New York (R. 25a). That complaint (*Rieser* complaint) alleged ownership by plaintiffs of an aggregate of $210,000 principal amount of Chicago and Alton Railroad Company 3% Refunding Mortgage Bonds (Alton Bonds) and purported to state a representative or class action on behalf of all other holders of such bonds (R. 29a-30a). The *Rieser* complaint also alleged that:

(a) B&O owned all of the common stock of, and exercised control over, the Chicago and Alton Railroad Company (Alton) from January 7, 1931, to November 25, 1942, when the United States District Court for the Northern District of Illinois (reorganization court) took custody of Alton under Section 77 of the Bankruptcy Act [47 Stat. 1474 (1933), as amended, 11 U. S. C. § 205 (1952)] (R. 30a, 35a);

(b) "In violation of its fiduciary duties", B&O, by various actions taken in the period 1931-1942, "caused loss, damage and injury to Alton, to the holders of Alton Bonds and to the property and assets covered by the lien of the mortgage securing the Alton Bonds" (R. 31a-34a);

(c) On April 1, 1941, Alton defaulted in the payment of the interest due on its bonds and, on November 25, 1942, petitioned the reorganization court under Section 77 of the Bankruptcy Act (R. 34a-35a);

(d) During that reorganization proceeding, the reorganization court was requested, on behalf of Alton bondholders, to direct the Section 77 trustee to prosecute a claim against B&O based upon the acts hereinabove alleged, but such request was denied (R. 36a-37a);

(e) The reorganization court allowed the claim of the Alton mortgage trustee on behalf of the owners and holders of Alton Bonds for the full principal amount of the Alton Bonds ($45,350,000) (R. 36a) but confirmed by final order entered May 31, 1947, a plan of reorganization which (i) sold the Alton properties free and clear of the mortgage to the Gulf, Mobile and Ohio Railroad Company, (ii) dissolved the Alton, (iii) discharged all claims of the bondholders against the Alton and the mortgaged properties by the payment of new Gulf, Mobile and Ohio Railroad Company securities having a fair and reasonable value of only $375 for each $1,000 principal amount of Alton Bonds, and (iv) reserved the rights of the Alton bondholders with respect to their claims, "if any", against B&O (R. 36a-38a); and

(f) Plaintiffs "are in the position of creditors who have secured judgments establishing their claims and have issued executions which have been satisfied to the extent of 37½ cents in respect of each dollar of principal amount and otherwise returned unsatisfied" (R. 38a).

Under the heading "FOR A FIRST CAUSE OF ACTION", the *Rieser* complaint claimed on behalf of Alton bond-

holders against B&O on a legal theory of derivative right that ran: (a) Alton has a tort claim against B&O; (b) Alton bondholders are in the position of "unsatisfied judgment creditors" of Alton; and, hence, (c) Alton Bondholders may claim against B&O in the right of Alton (R. 28a-39a).

Under the heading "FOR A SECOND CAUSE OF ACTION", the *Rieser* complaint claimed on behalf of Alton bondholders against B&O on a legal theory of independent right that ran: (a) the "acts and transactions" of B&O which constituted a tort against Alton also constituted a direct tort (fraud) against Alton bondholders; and, hence, (b) Alton bondholders may claim against B&O in their own right (R. 39a).

On April 27, 1954, B&O moved the district court for summary judgment on the ground that the *Rieser* complaint and all claims alleged therein were barred by New York statutes of limitations. In an opinion deciding that motion (Pet. 18), the district court described the *Rieser* complaint as asserting a claim under two legal theories, (i) a theory of derivative right against B&O, *i.e.*, an action by bondholders in their "capacity [as] creditors in aid of execution" of their debtor's claim against B&O (Pet. 20), and (ii) a theory of direct right against B&O for "fraud . . . upon the Alton bondholders" (Pet. 23). With respect to those theories, the district court concluded that under the law of New York the factual allegations of the *Rieser* complaint were an assertion by plaintiffs "not of a claim of their own, but one which is an asset of their debtor Alton" (Pet. 32).

On March 7, 1955, a partial summary judgment in favor of B&O was entered in the district court, adjudging that New York Civil Practice Act, Section 53, (a ten-year statute of limitations) barred all claims set forth in the *Rieser* complaint except those which might have arisen in the six-month period between May 7, 1942 (the date ten

years prior to the filing of the *Rieser* complaint) and November 25, 1942 (the date on which the reorganization court took custody of Alton) (R. 41a-42a; Pet. 18).

An appeal from that judgment was taken to the United States Court of Appeals for the Second Circuit. In an opinion reported at 228 F. 2d 563, that court affirmed, holding:

> "... plaintiffs contend that they suffered a direct and independent injury, apart from that done to Alton, and that a cause of action based on such injury accrued only after they had obtained a judgment with execution thereon returned unsatisfied. .... The crucial question here is whether the alleged acts of B & O (a) constitute harms to Alton, and but indirectly to plaintiffs, Alton's bondholders, and/or (b) constitute harms done directly to those bondholders. Absent a statute, we think they clearly came within the first category.
>
> "Alton, for these harms, could have held B & O liable; and so could Alton's bankruptcy trustee, as Alton's successor. Like the trustee, the plaintiffs stand in Alton's shoes; they have no shoes of their own. Significantly, plaintiffs cite no case holding otherwise, absent a statute.
>
> "...
>
> "... [T]he pertinent period of limitations is either (a) three years, under the New York Civil Practice Act, Section 49, subdivision 7, ... or (b) six years, under Section 48, subdivisions 1 or 8.
>
> "In short, making assumptions most generous to plaintiffs, suit on the claims against B & O were barred on November 25, 1948, *i.e.*, six years from the appointment of Alton's bankruptcy trustee on November 25, 1942." (228 F. 2d at 564-65; Pet. 40-42.)

On April 2, 1956, this Court denied certiorari. *Rieser, et al.* v. *Baltimore & Ohio Railroad Co.*, 350 U. S. 1006.

Since the statutory grounds (New York Civil Practice Act, Sections 48 and 49) upon which the court of appeals

had based its affirmance of partial summary judgment for B&O necessarily precluded any claim under the *Rieser* complaint for the period May 7, 1942 to November 25, 1942, upon remand, B&O moved for summary judgment dismissing the complaint and action in toto. The district court granted that motion. (R. 44a-46a).*

The Instant Action

On February 15, 1957, Koblitz instituted the instant action in the Supreme Court of the State of New York, County of New York (R. 23a). On March 7, 1957, invoking the diversity jurisdiction of the federal court, B&O caused the suit to be removed to the United States District Court for the Southern District of New York (R. 1a, 23a-24a). The complaint of Koblitz (*Koblitz* complaint) alleges ownership by him of $50,000 principal amount of Alton Bonds and purports to state a class or representative action on behalf of all other Alton bondholders. Its factual allegations were conceded below, and are conceded here (Pet. 5, 8), to be substantially identical with those of the *Rieser* complaint.** The single difference between the two complaints is that the *Koblitz* complaint alleges that B&O performed its tortious acts (frauds) in concert and conspiracy with Alton, whereas the *Rieser* complaint did not thus charge Alton (Pet. 9).

B&O moved for summary judgment in the instant action on the ground that the claim asserted in the *Koblitz* com-

*Although petitioner also appealed from that judgment to the court below, upon failure to prosecute the appeal, as required by Rule 14(c) of the court, B&O applied to dismiss it. That application was granted April 16, 1957 (R. 47a). Petitioner moved the court to reinstate the appeal but the motion was denied May 8, 1957. A petition for rehearing was denied June 4, 1957.

**For convenience, there is appended to this brief a TABLE OF COMPARISON which sets forth in parallel columns all of the allegations of the instant complaint and the virtually identical allegations of the *Rieser* complaint.

plaint is res judicata and, in any event, barred by applicable statutes of limitations (R. 21a-22a). On July 11, 1958, the district court granted the B&O motion on the res judicata ground (R. 10a) and thereupon final judgment was entered dismissing the *Koblitz* complaint (R. 20a).

On April 28, 1959, following timely appeal, the court below affirmed on the opinion of the district court, declaring:

> ". . . In addition to the estoppel of the former judgment we find that the basic point now argued as to whether the source of appellant's claim is derivative or direct, was determined in the appeal to this Court from the adverse judgment in the prior action. *Riesel* v. *Baltimore & Ohio R. R.*, 2 Cir., 1955, 228 F. 2d 563. Thus appellant is bound not only by a direct but also by a collateral estoppel." (Pet. 16)

ARGUMENT

Koblitz urges a grant of certiorari by this Court, contending that the decision below is in conflict with that in *Southern Pacific Company* v. *Bogert*, 250 U. S. 483 (Pet. 11-14). There is no conflict. The decision below clearly accords with the applicable law of the State of New York.

A. *Southern Pacific Company* v. *Bogert*, 250 U. S. 483.

In *Bogert*, plaintiffs were minority stockholders in a corporation the assets of which had been sold to the majority stockholder at a foreclosure sale in an equity receivership reorganization. The assets had been sold at a price which did not permit a distribution to plaintiffs except upon payment of an allegedly excessive assessment. For years plaintiffs made collateral attacks upon the foreclosure sale but were unsuccessful in having it set aside. Their complaint in *Bogert*, however, unlike their complaints in the prior actions, pleaded the fact of acceptance and ratification

of the foreclosure sale and sought recovery only for the refusal of the majority stockholder to accord the minority participation on a fair pro rata basis in the equity of the reorganized company.

Bogert, then, involved new operative facts and, therefore, a claim different from those adjudicated earlier between the parties. But here, the two claims remain identical in all essential respects. Koblitz in both actions has relied upon the same alleged acts of B&O, all purportedly occurring prior to the Alton reorganization decree (May 31, 1947). In each case Koblitz has sued to recover the same debt (the bonded indebtedness) out of the assets which B&O is alleged wrongfully to have withheld or received prior to 1942 from the Alton. Therefore, in so far as res judicata is concerned, the *Bogert* decision has no bearing on the instant case.

B. The Decision Below Is Correct.

Federal jurisdiction over this action is grounded upon diversity of citizenship, the applicable law being that of the State of New York. Under that law, a judgment on the merits creates an absolute bar to a subsequent action on the same cause of action between the same parties. *New York State Labor Relations Board* v. *Holland Laundry, Inc.*, 294 N. Y. 480, 493, 494 (1945); *Miller* v. *National City Bank of New York*, 166 F. 2d 723, 726 (2d Cir. 1948).* Koblitz concedes that the *Riesey* complaint, and

*Although Koblitz asserts that the judgment dismissing the *Riesey* complaint and action was not "adjudication of the merits" of that case (Pet. 10-11), he concedes that a valid and final personal judgment, based on the bar of New York statutes of limitations, was rendered there in favor of B&O and against him (Pet. 3-4, 10-11). The law is clear that for purposes of applying the doctrine of res judicata such a judgment is a judgment on the merits. *Miller* v. *National City Bank of New York*, 116 F. 2d 723 (2d Cir. 1948); *Accord, Angel* v. *Bullington*, 330 U. S. 183; *Restatement, Judgments* § 49, comment a.

the complaint in the instant action allege exactly the same injury to the same property by reason of the same acts by B&O (Pet. 5). Since Koblitz has not pleaded operative facts different in any way from those pleaded in the *Rieser* action, he has not pleaded a new cause of action. *Ibid.*

Nor can Koblitz contend that the instant action is not barred by the judgment in the *Rieser* action because he now pleads a legal theory of "direct" right of recovery in Alton bondholders against B&O whereas, in the prior litigation, he had pleaded only a legal theory of "derivative" right of recovery (Pet. 4-8). Variations in legal theory do not create variations in the causes of action for purposes of applying the doctrine of res judicata. See *Williamson* v. *Columbia Gas & Electric Corp.*, 186 F. 2d 464 (3d Cir. 1950), *cert. denied*, 341 U. S. 921.* Furthermore, Koblitz is clearly in error in suggesting that the complaint in the *Rieser* action did not proffer the legal theory of "direct" right of recovery (Pet. 4-5). In the so-called "SECOND CAUSE OF ACTION" of the *Rieser* complaint, Koblitz claimed on behalf of Alton Bondholders on a theory of direct tort by B&O against those bondholders. Thus, the "SECOND CAUSE OF ACTION", after repeating and realleging every

*Koblitz's discussion of his new legal theory as raising a new cause of action is not only erroneous under the law of res judicata but it is extremely misleading substantively. Koblitz argues that a derivative action on behalf of a corporation does not lie where all stockholders have consented to conduct which impairs the ability of the corporation to pay its debts. For this proposition, Koblitz cites and quotes from many cases which hold only that, vis-a-vis subsequent stockholders, waste of corporate assets consented to by all stockholders at the time does not give rise to a derivative cause of action (Pet. 12). Those cases are irrelevant here. Vis-a-vis creditors, such as Alton bondholders, any waste of corporate assets, though consented to by stockholders, which impairs the ability of a corporation to pay its debts is illegal and does give rise to a derivative cause of action on the part of creditors. The court below so held in the *Rieser* appeal (228 F. 2d at 565) and further observed that in New York, absent a statute, such conduct gives rise only to a derivative cause of action on the part of creditors. That holding is amply supported by authority. See, *e.g.*, *Austrian* v. *Williams*, 198 F. 2d 697 (2d Cir. 1952).

allegation of the "FIRST CAUSE OF ACTION", further alleged that:

> "The acts and transactions complained of also constitute a fraud practiced by the defendant upon . . . the holders of Alton Bonds, including the plaintiffs." (R. 39a)

Koblitz fully intended that the legal theory of direct right of recovery alleged in the "SECOND CAUSE OF ACTION" should be in issue in the *Rieser* litigation. He made that amply clear in his briefs to the court of appeals and in his petition to this Court for a writ of certiorari. For example, in his main brief in the court of appeals in the *Rieser* action, Koblitz asserted:

> "The complaint prays (p. 13) judgment, not for the amount of any claim by Alton against the appellee, but for the deficiency due the bondholders. . . ." (Appellants' Brief, No. 23560, p. 8).

In a reply brief, he further stated:

> "Appellants insist that they are not asserting claims which belong or ever belonged to Alton. They are mounting independent and wholly different causes of action. . . ." (p. 2)

In his supplemental memorandum, submitted after argument to the court of appeals, Koblitz reiterated:

> "In brief and argument we have urged (a) that this creditors' bill asserts claims which belong, and rest upon direct injury, to the creditors represented by the plaintiffs. . . ." (p. 1)

Finally, after the adverse decision in the court of appeals (228 F. 2d 563), Koblitz in a petition to this Court for a writ of certiorari, stated:

> ". . . the legal pivot upon which this entire case turns is whether, under New York law, a plaintiff in a creditor's bill asserts a cause of action belonging

> to his principal debtor or a cause of action belonging independently to himself" (p. 7)

and, further,

> ". . . this creditors' suit is not derivative but is direct, and seeks recovery for injury to the bondholders and not to Alton" (p. 16)

and, lastly,

> ". . . [p]etitioners' action . . . is not, in any sense, 'derivative', nor is Alton petitioners' predecessor in interest'." (Reply Br. p. 1)

It is impossible to read those excerpts and not conclude, as did the court below, that:

> ". . . the basic point now argued as to whether the source of appellant's claim is derivative or direct, was determined in the appeal to this Court from the adverse judgment in the prior action." (Pet. 17)

In New York, in such circumstances, the doctrine of res judicata puts an end to the matter. *New York State Labor Relations Board* v. *Holland Laundry, Inc.*, 294 N. Y. 480, 494 (1945).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JOHN F. HUNT, JR.,
Of Counsel.

August 14, 1959.

TABLE OF COMPARISON

Instant Complaint [full text] (R. 2a-9a)	*Rieser-Koblitz Complaint* [excerpts] (R. 28a-40a)
FIRST: That the plaintiff is owner and holder of $50,000.00 principal amount of bonds of The Alton Railroad Company and brings this action on behalf of himself and on behalf of the other owners of bonds of The Alton Railroad Company.	4. The plaintiffs are the bona fide owners and holders of Alton Bonds in the following principal amounts: Plaintiff — Principal Amount Norvin Rieser ..... $20,000 Milton S. Koblitz ..... 50,000 3. This is a representative class action brought on behalf and for the benefit of the owners and holders of Alton Bonds.
SECOND: That the defendant is and at all times hereinafter mentioned was a railroad corporation, duly organized and existing and consolidated under the laws of the States of Maryland and Virginia and at all times hereinafter mentioned, the defendant herein operated and still operates a system of railroads in the United States.	1. The defendant is, and at all the times hereinafter mentioned was, a railroad corporation organized, existing and consolidated under the laws of the States of Maryland and Virginia.
THIRD: That at all times between July 18, 1931 and May 31, 1947, The Alton Railroad Company, an Illinois railroad corporation, hereinafter called "Alton" was the obligor on $45,350,000., principal amount of a 3% refunding mortgage bond of the Chicago and Alton Railroad Company, hereinafter called Alton Bonds.	2. At all times between July 18, 1931 and May 31, 1947, The Alton Railroad Company, an Illinois railroad corporation (hereinafter called "Alton"), was the obligor on $45,350,000. principal amount of The Chicago and Alton Railroad Company 3% Refunding Mortgage Bonds (hereinafter called "Alton Bonds") which were secured by a first mortgage upon all of the assets of Alton.
FOURTH: That on or about January 7th, 1931, the defendant acquired and became the owner	5. On or about January 7, 1931, the defendant acquired and became the owner of all of the

Instant Complaint [full text] (R. 2a-9a)	*Rieser-Koblitz Complaint* [excerpts] (R. 28a-40a)
of all of the issued and outstanding capital stock of Alton and continued to own such stock until on or about May 31st, 1947.	outstanding capital stock of Alton and continued to own said stock until after November 25, 1942.
FIFTH: That on or about January 7th, 1931, Alton was an operating railroad with a substantial complement of rolling stock and equipment, profitable traffic interchange agreements and arrangements with certain railroads, beneficial contracts and arrangements with Western Union Telegraph Company, The Pullman Company, Fruit Growers Express Company and others, and had its own traffic solicitation department which concentrated its efforts on the promotion of business over the Alton lines or Alton connections and it had the benefit of a close relationship with suppliers of its requirements of fuel and other materials and supplies who in turn regularly and systematically favored Alton with substantial freight.	7. At the time the defendant obtained control of Alton as aforesaid, Alton was an operating railroad with a substantial complement of rolling stock and equipment, profitable traffic interchange agreements and arrangements with certain railroads, beneficial contracts and arrangements with Western Union Telegraph Company, The Pullman Company, Fruit Growers Express Company and others, and having its own traffic solicitation department which concentrated its efforts on the promotion of business over the Alton lines or Alton connections. In addition, Alton had the benefit of a close relationship with suppliers of its requirements of fuel and other materials and supplies who in turn regularly and systematically favored Alton with substantial freight traffic.
SIXTH: That upon acquiring the stock of Alton, as aforesaid, the defendant and Alton entered upon a design, scheme and plan to defraud the creditors of Alton, including plaintiff and other holders of Alton Bonds.	22. The acts and transactions complained of also constitute a fraud practised by the defendant upon Alton and the holders of Alton Bonds, including the plaintiffs.
SEVENTH: Pursuant to said design, plan and scheme, Alton elected as officers and directors of Alton, servants and employees of the defendant and Alton became a part of, an instrumentality	6. During the entire period from July 18, 1931 to November 25, 1942, the defendant nominated and elected each and every director of Alton and designated each and every executive and

Instant Complaint [full text] (R. 2a-9a)	*Riesser-Koblitz Complaint* [excerpts] (R. 28a-40a)
and agency of the defendant's railroad system.	policy-making officer of Alton, and such directors and officers functioned and acted in respect of the affairs of Alton solely as servants and agents of the defendant and in accordance with directions given and policies formulated by the defendant. . . .
EIGHTH: That in furtherance of the plan, scheme and design as aforesaid, the defendant and Alton committed and performed the following acts and deeds:	8. In violation of its fiduciary duties, . . . , the defendant, between July 18, 1931 and November 25, 1942, caused loss, damage and injury to . . . the holders of Alton Bonds . . . and unjust enrichment of itself, by each and all of the following acts:
(a). The defendant with the approval, consent and cooperation of Alton, used, employed and appropriated Alton's property and equipment to its own use without paying therefor a fair and reasonable compensation;	(c) During said period, the defendant used Alton's tracks and equipment for its own benefit without paying Alton the reasonable value of the use thereof.
(b). Alton diverted to the defendant's lines traffic, which in regular course, would have moved over Alton's lines if Alton were operated as an independent railroad and Alton hauled such traffic only as could not be hauled over defendant's lines with the result that income which would otherwise have been received by Alton, was diverted to the defendant;	(a) . . . defendant caused traffic which would normally have moved over Alton's lines to be diverted to defendant's lines, and increased hauls over its own lines with consequent decreases in hauls over Alton's lines.
(c). Alton interchanged traffic with lines chosen for it by the defendant rather than with lines with which Alton had previously maintained profitable relations and good will and by reason thereof, there was a loss of in-	(a) . . . defendant caused Alton to interchange traffic with lines chosen by defendant rather than with lines with which Alton had previously maintained profitable relations and good will. . . . By reason of the acts recited in this

Instant Complaint [full text] (R. 2a-9a)	*Rieser-Koblitz Complaint* [excerpts] (R. 28a-40a)
come to Alton and an increase of income to the defendant;	paragraph the defendant was unjustly enriched and Alton and the holders of Alton Bonds, including the plaintiffs, were damaged. . . .
(d). The traffic solicitation department of Alton was eliminated and there was set up a consolidated traffic solicitation department and through said solicitation department, there was diverted to the defendant's lines traffic and income which Alton would have received if Alton had been maintained as a separate and independent railroad.	(a) . . . defendant . . . eliminated the traffic solicitation department of Alton and set up a consolidated traffic solicitation department, the true purpose and effect of which was to insure preferential treatment for the defendant in the solicitation of traffic, at the expense of Alton.
(e). Alton's tracks and equipment were used by the defendant for its own benefit without payment to Alton of the reasonable value for the use thereof and the defendant had repairs made to its own rolling stock by use of the facilities of Alton and otherwise used Alton's facilities without paying the reasonable value of said use and the services performed;	(c) During said period, the defendant used Alton's tracks and equipment for its own benefit without paying Alton the reasonable value of the use thereof. In addition, the defendant caused repairs to be made to its own rolling stock through the facilities of Alton, and otherwise used Alton's facilities, without paying the reasonable value of said use. . . .
(f). Alton made purchases of equipment, coal and other supplies from shippers using the defendant's lines and thus caused a diversion of substantial income to the defendant's lines and a loss of income to Alton.	(d) During the said period, defendant caused the diversion of purchases of company equipment of coal and other supplies from potential shippers over Alton's lines to potential shippers over defendant's lines and thus severely damaged Alton's business relations with such shippers and reduced Alton's net income. . . .
(g). Alton negotiated new contracts with Western Union Telegraph Company, the Pullman Company and Fruit Growers Express Company, upon terms which benefited the defendant	(e) . . . defendant caused Alton to negotiate new contracts with Western Union Telegraph Company, The Pullman Company and Fruit Growers Express Company containing terms less

Instant Complaint [full text] (R. 2a-9a)	*Rieser-Koblitz Complaint* [excerpts] (R. 28a-40a)
and which caused a diversion of substantial income from Alton to the defendant;	favorable to Alton and more favorable to defendant. . . .
(h). During said period Alton used the rolling stock of the defendant for which Alton paid to the defendant an excessive charge and Alton and the defendant stored Alton's rolling stock on side tracks and permitted said rolling stock to rust and become worthless;	(b) . . . defendant used largely its own rolling stock to meet both its own requirements and the requirements of Alton and defendant neglected to keep Alton's rolling stock, including engines, passenger cars and freight cars, in proper order and repair as required by good railroad practice; instead, defendant stored such rolling stock on side tracks in the open, subject to the action of the elements, and permitted said rolling stock to rust and rot and otherwise deteriorate, and failed to make replacements, so that most of it became useless and valueless.
	. . . By virtue of the defendant's wrongful acts as aforesaid, Alton suffered . . . loss of capital assets and values. . . .
(i). During the years 1940 and 1941, Alton suffered an aggregate net loss of about $2,000,000. and the defendant and Alton filed a consolidated Federal Tax return for said years and in said return offset said loss against the profits of the defendant and thus Alton lost the right to apply said loss against income earned by it in later years;	(f) During the years 1940 and 1941, Alton, as operated by defendant, suffered an aggregate net loss of about $2,000,000. . . . However, defendant filed federal tax returns in respect of the operations of Alton and itself for the years 1940 and 1941 upon a consolidated basis . . . If defendant had not forced Alton to include the results of its operations in consolidated returns, as aforesaid, Alton would have been able and would have received the benefit of such excess profits tax credit and would have . . . saved federal taxes, which it was forced to and did pay. . . .

Instant Complaint [full text] (R. 2a-9a)	*Ricser-Koblitz Complaint* [excerpts] (R. 28a-40a)
(j). During the period aforesaid, defendant and Alton in dividing the revenues upon traffic interchanged between them, allowed the defendant excessive percentages and portions of said revenues and fixed the amounts payable to Alton below the amount justly and reasonably payable therefor.	(g) During said period, the defendant discriminated unfairly against Alton in dividing revenues on traffic interchanged between them in that the defendant retained for itself excessive percentages and portions of said revenues and fixed the amounts payable to Alton below the amounts justly and reasonably due to Alton out of said revenues.
NINTH: That as a result of the acts hereinabove alleged, Alton became insolvent and became unable to meet, pay and discharge its obligations due to its creditors, including the holders of Alton Bonds.	10. On or about April 1, 1941, Alton defaulted in the payment of interest on the Alton Bonds. 11. By November 25, 1942, as a result of the acts of the defendant aforesaid during the prior eleven years, the financial condition of Alton had deteriorated to such an extent that it was unable to function properly as an independently operating railroad. [Total losses alleged in paragraph 8 (App. 31a-34a) in Excess of $30,000,000.]
TENTH: That during the period from January 7th, 1931 to and including November 25th, 1942, the income diverted from Alton and received by the defendant and the other benefits conferred upon the defendant through the use and appropriation to itself of Alton's property and equipment amounted to upwards of $30,000,000	
ELEVENTH: That on or about April 1st, 1941, Alton defaulted in the payment of interest upon the bonds aforementioned and thereafter, the Trustee under the indenture governing said bonds, declared the entire principal amount, namely, $45,350,000, due and payable.	10. On or about April 1, 1941, Alton defaulted in the payment of interest on the Alton Bonds. Pursuant to the terms of the mortgage indenture securing said Bonds, the entire principal amount, namely, $45,350,000, became due and payable, and the same was not paid.

Instant Complaint
[full text] (R. 2a-9a)

TWELFTH: That on or about November 25th, 1942, Alton filed petition for reorganization under Section 77 of the Bankruptcy Act, in the United States District Court for the Northern District of Illinois, Eastern Division.

THIRTEENTH: That thereafter, a plan of reorganization was submitted, approved and consented to in the reorganization proceeding aforementioned and on or about May 31st, 1947, said plan was duly confirmed by the District Court for the Northern District of Illinois, Eastern Division.

FOURTEENTH: That the order confirming plan of reorganization aforementioned, provided in part as follows:

"(a) That Alton's assets and properties be transferred to Gulf, Mobile and Ohio Railroad Company (hereinafter called 'Gulf') free and clear of the mortgage securing the Alton Bonds and other claims against Alton, and also that Alton be dissolved.

(b) That Gulf exchange its own bonds and stock for claims held by owners and holders of Alton Bonds as follows; for each $1,000. Alton Bond (principal amount) Gulf issue its own 4% General Mortgage Income Bond, Series B, due 2044, in the sum

Rieser-Koblitz Complaint
[excerpts] (R. 28a-40a)

11. . . . defendant . . . caused Alton to file, on or about November 25, 1942, a petition for reorganization under Section 77 of the Bankruptcy Act . . . in the United States District Court for the Northern District of Illinois, Eastern Division. . . .

15. On or about May 31, 1947, following confirmation of a plan of reorganization for Alton in said Reorganization Proceeding, a final order was entered by the Reorganization Court giving effect to and providing for consummation of said plan. . . .

15. On or about May 31, 1947, following confirmation of a plan of reorganization for Alton in said Reorganization Proceeding, a final order was entered by the Reorganization Court giving effect to and providing for consummation of said plan, and directing as follows:

(a) That Alton's assets and properties be transferred to Gulf, Mobile and Ohio Railroad Company (hereinafter called "Gulf") free and clear of the mortgage securing the Alton Bonds and other claims against Alton, and also that Alton be dissolved.

(b) That Gulf exchange its own bonds and stock for claims held by owners and holders of Alton Bonds as follows: for each $1,000. Alton Bond (principal amount) Gulf issue its own 4% General Mortgage Income Bond, Series B, due 2044, in the sum

Instant Complaint [full text] (R. 2a-9a)	*Rieser-Koblitz Complaint* [excerpts] (R. 28a-40a)
of $500 (principal amount) plus seven and one-quarter (7¼) shares of Gulf's no par value common stock.	of $500 (principal amount) plus seven and one-quarter (7¼) shares of Gulf's no par value common stock.
(c) That the rights of owners and holders of Alton Bonds to assert any claim against the defendant be specifically preserved and reserved."	(c) That the rights of owners and holders of Alton Bonds to assert any claim against the defendant be specifically preserved and reserved.
FIFTEENTH: That, in effecting the distribution of securities pursuant to such order and in accordance therewith, the Alton Bonds were not cancelled for all purposes, but were perforated and stamped by the Exchange Agent named in the plan with the following legend:	15. . . . In effecting the distribution of securities pursuant to such order and in accordance therewith, the Alton Bonds were not cancelled for all purposes, but were perforated and stamped by the Exchange Agent named in the plan with the following legend:
"Pursuant to order of United States District Court for the Northern District of Illinois, Eastern Division, entered May 26, 1947, in the matter of the Alton Railroad Company, Debtor, No. 79081. This Bond has been perforated and cancelled for all purposes except for the purpose of evidencing right of the bearer or registered owner to a claim, if any, against the Baltimore and Ohio Railroad Company."	"Pursuant to order of United States District Court for the Northern District of Illinois, Eastern Division, entered May 26, 1947, in the matter of the Alton Railroad Company, Debtor, No. 79081. This Bond has been perforated and cancelled for all purposes except for purpose of evidencing right of the bearer or registered owner to a claim, if any, against the Baltimore and Ohio Railroad Company."
SIXTEENTH: That the fair and reasonable value of the Gulf securities so exchanged for each $1,000. Alton Bond amounted to $375., leaving an unsatisfied claim of $625. plus interest on each $1,000. Alton Bond. In the aggregate, the fair and reasonable value of the new securities so exchanged for the Alton Bonds	16. The fair and reasonable value of the Gulf securities so exchanged for each $1,000. Alton Bond amounted to $375., leaving an unsatisfied claim of $625. plus interest on each $1,000. Alton Bond. In the aggregate, the fair and reasonable value of the new securities so exchanged for the Alton Bonds amounted to

Instant Complaint [full text] (R. 2a-9a)	*Rieser-Koblitz Complaint* [excerpts] (R. 28a-40a)
amounted to $17,006,250., leaving unsatisfied claims of holders of Alton Bonds aggregating $28,343,750. with interest from April 1st, 1941.	$17,006,250., leaving unsatisfied claim of holders of Alton Bonds aggregating $28,343,750., with interest from April 1, 1941.
SEVENTEENTH: That by reason of the foregoing, the plaintiff and all other holders of Alton Bonds have had their claims recognized and fully established but unpaid except to the extent of $375. for each $1,000. of Alton Bonds, and are in the position of creditors who have secured judgments establishing their claims and have issued executions which have been satisfied to the extent of 37½ cents in respect of each dollar of principal amount and otherwise returned unsatisfied.	16. By reason of the foregoing, the plaintiffs and all other holders of Alton Bonds have had their claims recognized and fully established but unpaid except to the extent of $375. for each $1,000. of Alton Bonds, and are in the position of creditors who have secured judgments establishing their claims and have issued executions which have been satisfied to the extent of 37½ cents in respect of each dollar of principal amount and otherwise returned unsatisfied.
EIGHTEENTH: That there remains due and owing to the holders of the bonds aforementioned the sum of $28,343,750., with interest thereon from the first day of April, 1941, which amount the holders of the Alton Bonds could not ascertain and determine until the entry of the order of May 31st, 1947.	19. The damages sustained by the holders of Alton Bonds by reason of the acts of the defendant set forth above are $28,343,750., with interest from April 1, 1941. 23. The facts . . . were not discovered by the plaintiffs or any of them until long after the institution of the Reorganization Proceeding as aforesaid.
NINETEENTH: Plaintiff has no adequate remedy at law.	20. Plaintiffs have no adequate remedy at law.
WHEREFORE, plaintiff prays for judgment as follows:	WHEREFORE, plaintiffs pray judgment as follows:
(a) That it be adjudged that from January 7th, 1931 to and including November 25th, 1942, Alton was an agency and instrumentality of the defendant;	

Instant Complaint [full text] (R. 2a-9a)	*Rieser-Koblitz Complaint* [excerpts] (R. 28a-40a)
	(b) adjudging, decreeing and ordering the defendant to pay to said receiver or custodian a sum not less than $28,343,750., with interest thereon from April 1, 1941 . . .;
(b) That the defendant account (1) for all income diverted from Alton to itself; (2) for all damage suffered by the holders of Alton Bonds by reason of the acts of the defendant from January 7th, 1931 to and including November 25th, 1942; and (3) for all profits made by the defendant by reason of the acts aforesaid;	
(c) That a Receiver be appointed to receive payment of the sums found due from the defendant and to distribute same to the holders of the Alton Bonds;	(a) appointing a receiver or other judicial custodian to receive and distribute the proceeds of this action for the benefit of the holders of Alton Bonds;
(d) That plaintiff be paid all his costs and disbursements of this action, including counsel fees; and	(c) directing said receiver or custodian as to payment of plaintiffs' expense, including counsel fees, and distribution of the balance to the holders of Alton Bonds . . .
	(b) adjudging, decreeing and ordering the defendant to pay . . . costs and disbursements of this action;
(e) That plaintiff have such other and further relief as to this Court may seem just and proper.	(d) directing such other and further relief as may be just and proper.

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IN THE

Supreme Court of the United States

October Term, 1959

No. 232

MILTON KOBLITZ,

Petitioner,

AGAINST

THE BALTIMORE AND OHIO RAILROAD COMPANY,

Respondent.

PETITIONER'S REPLY BRIEF

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Respondent.

PETITIONER'S REPLY BRIEF

I

The *Rieser* complaint *did not* in its *second cause* of action set forth a direct cause of action against B. & O.

The respondent seems most anxious to make this Court believe that in its second cause of action (R. 39a), the *Rieser* complaint set forth a direct cause of action against B. & O.

And starting from that erroneous premise, the respondent argues that the judgments in the *Rieser* action therefore are a bar to this direct and independent action against B. & O.

The respondent is in error.

At page 4 of its brief the respondent says:

> "Under the heading 'For a Second Cause of Action', the *Rieser* complaint claimed on behalf of Alton bondholders against B & O on a legal theory of independent right that ran: (a) the 'acts and transactions' of B & O which constituted a tort against Alton also constituted a direct tort (fraud) against Alton bondholders; and, hence, (b) Alton bondholders may claim against B & O in their own right (R. 39a)."

And on the same page 4, the respondent says:

> "* * * In an opinion deciding that motion (Pet. 18), the district court described the *Rieser* complaint as asserting a claim under two legal theories, (i) a theory of derivative right against B & O, i.e., an action by bondholders in their 'capacity (as) creditors in aid of execution' of their debtor's claim against B & O (Pet. 20), and (ii) a theory of direct right against B & O for 'fraud * * * upon the Alton bondholders' (Pet. 23)."

And at pages 9 and 10 of its brief, respondent says:

> "* * * Furthermore, Koblitz is clearly in error in suggesting that the complaint in the *Rieser* action did not proffer the legal theory of 'direct' right of recovery (Pet. 4-5). In the so-called 'Second Cause of Action' of the *Rieser* complaint, Koblitz claimed on behalf of Alton Bondholders on a theory of direct tort by B. & O. against those bondholders. Thus, the 'Second Cause of Action', after repeating and realleging every allegation of the 'First Cause of Action', further alleged that:

'The acts and transactions complained of also constitute a fraud practiced by the defendant upon * * * the holders of Alton Bonds, including the plaintiffs' (R. 39a)."

With respect to the causes of action in the *Rieser* case, Judge Murphy in his opinion (123 F. Supp. 44, 52, Pet. p. 32), said:

"* * * The language of this complaint indicates plaintiffs are asserting, not a claim of their own, but one which is an asset of their debtor Alton. For example, plaintiffs allege in paragraph 16 that they:

'* * * are in the position of creditors who have secured judgment establishing their claims and have issued executions which have been satisfied to the extent of 37½ cents in respect of each dollar of principal amount and otherwise returned unsatisfied.'

"And in paragraph 17 they allege:

'The claim asserted against the defendant in this action constitutes the only asset on which the unsatisfied claims of the holders of Alton Bonds may be satisfied.'"

And with respect to the second cause of action, Judge Murphy said (123 F. Supp. p. 53, Pet. pp. 33-34):

"* * * In the second count of their complaint, plaintiffs allege that the 'acts and transactions complained of also constitute a fraud practiced by the defendant upon Alton and the holders of Alton Bonds, including the plaintiffs' and the 'facts constituting said fraud were not discovered by the plaintiffs or any of them until long after the institution of the Reorganization Proceeding.'

> "Such 'allegations of the complaint' may well be 'mere conclusions and even if accepted as allegations of fact they are only incidental to the cause of action brought against defendants on the ground that they have disregarded their duty to the corporation. Such allegations do not constitute a cause of action "to procure a judgment on the ground of fraud" * * * under the provisions of section 48, subdivision 5, of the Civil Practice Act, * * *.'"

The Court of Appeals in affirming the *Rieser* judgment said (228 F. 2nd 563, 564, 565, Pet. pp. 39-40):

> "2. A judgment-creditor, with execution returned unsatisfied, may, without relying on a statute, by an 'old-fashioned' creditors' bill, have an equitable levy on an available asset of his debtor. The asset may consist of a claim against a third person for a wrong that person did to the debtor. If that wrong be regarded as also done to the creditor, it is only an indirect wrong, and the creditor's suit is derivative, in effect.
>
> "However, plaintiffs contend that they suffered a direct and independent injury, apart from that done to Alton, and that a cause of action based on such injury accrued only after they had obtained a judgment with execution thereon returned unsatisfied. The crucial question here is whether the alleged acts of B. & O. (a) constitute harms to Alton and but indirectly to plaintiffs, Alton's bondholders, and/or (b) constitute harms done directly to those bondholders. Absent a statute,* we think they clearly came within the first category."

---

* The Court of Appeals had in mind Section 15 of the New York Stock Corporation Law, which makes certain acts also direct wrongs against creditors and gives creditors a direct remedy.

The statement in the *per curiam* opinion of the Court of Appeals (by a different panel) that

> "* * * In addition to the estoppel of the former judgment we find that the basic point now argued as to whether the source of appellant's claim is derivative or direct, was determined in the appeal to this Court from the adverse judgment in the prior action. *Rieser* v. *Baltimore & Ohio R.R.*, 2 Cir., 1955, 228 F. 2d 563. Thus appellant is bound not only by a direct but also by a collateral estoppel." (Pet 16)

is erroneous.

"Whether the source of appellant's claim is derivative or direct" was not an issue in the *Rieser* action.

The plaintiffs in that action sought to recover in the right of Alton upon a claim which the complaint in that action alleged—but erroneously—Alton had against B. & O.

The lower courts, upon the complaint before them, accepted for the purpose of the motion the truth of the allegations therein set forth, and held that such a claim in the right of Alton, was outlawed and therefore not available.

A perusal of the opinions of the lower courts in the *Rieser* action, will convince this Court that (a) the respondent is in error because the second cause of action in the *Rieser* complaint did not set forth a direct cause of action against B. & O. and that (b) the Court of Appeals, in the instant action, is in error when it said that "whether the source of appellant's claim is derivative or direct was determined in the appeal to this Court from the adverse judgment in the prior action".

II

The contention that there is no difference between the instant action and the *Rieser* action is erroneous and proceeds from a misconstruction of the instant complaint and from a lack of understanding of the principles governing an action to set aside a fraudulent conveyance.

The respondent sees no difference between the instant complaint (R. 2a-9a) and the complaint in the *Rieser* action (R. 28a-40a). The respondent says (Br., p. 6):

> "* * * The single difference between the two complaints is that the Koblitz complaint alleges that B. & O. performed its tortious acts (frauds) in concert and conspiracy with Alton, whereas the Rieser complaint did not thus charge Alton (Pet. 9)."

The respondent is in error.

In the *Rieser* action the plaintiffs sued to recover against B. & O. in the right of Alton upon a claim which plaintiffs in that action believed Alton had against B. & O. The complaint in that action alleged that (R. 31a) "in violation of its fiduciary duties * * * the defendant * * * caused loss and injury to Alton".

The instant complaint charges that Alton conveyed corporate opportunities to B. & O. in fraud of Alton's creditors. Unlike the complaint in the *Rieser* action, the instant complaint (R. 2a-9a) makes no charges of wrongdoing by B. & O. against Alton.

This is a direct and independent action and not a derivative action.

This action is brought in behalf of Alton's bondholders to set aside fraudulent conveyances made by Alton to B. & O., pursuant to a conspiracy to defraud Alton's creditors. B. & O. was not liable in tort for conspiring with Alton to defraud Alton's Bondholders. *Adler* v. *Fenton*, 65 U. S. 407; *Duell* v. *Brewer*, 92 Fed. 2d 59 (2 C. C. A. 1937).

However, B. & O. is liable to account for property fraudulently conveyed to it.

In *Shepard* v. *Commissioner of Internal Revenue*, 101 F. 2d 595 (7 C. C. A. 1939), cert. den. 307 U. S. 639, the Court said at page 599:

> "The theory of these holdings is that courts of equity will protect creditors from fraudulent action on the part of debtors by holding the recipient of the debtor's property as trustee thereof for the benefit of creditors of said debtor."

See also:

Hilliard v. *Sisil*, 192 F. 2d 806 (9 C. A. 1951).

Plaintiff seeks to have restored to Alton's creditors the profits and benefits which B. & O. derived from the corporate opportunities fraudulently conveyed to it by Alton because these opportunities cannot now be restored to the creditors.

The corporate opportunities fraudulently conveyed were intangibles and an accounting is necessary to determine the amount of those profits.

The allegations in the complaint that B. & O. conspired with Alton and that it participated in the fraudulent conveyances to it by Alton were put into the *Koblitz* complaint to show that B. & O. had guilty knowledge of Alton's fraudulent intent when it (B. & O.) accepted these conveyances from Alton.

The complaint against B. & O. is that it was the recipient of those corporate opportunities and benefits and seeks an accounting because it was the fraudulent grantee of those corporate opportunities and benefits.

III

The issues in the *Rieser* action are defined by the complaint in that action and not by the statements and arguments made in briefs or petitions.

In its brief (p. 10), the respondent says:

> "Koolitz fully intended that the legal theory of direct right of recovery alleged in the 'Second Cause of Action' should be in issue in the *Rieser* litigation. He made that amply clear in his briefs to the court of appeals and in his petition to this Court for a writ of certiorari."

And then follow excerpts from the briefs in the Court of Appeals in that case and from the petition to this Court for a writ of certiorari.

Briefs are not pleadings.

It is quite evident that the plaintiffs in the *Rieser* action soon realized that they had brought the wrong action.

But the issues in that case were fixed by the *Rieser* complaint and could not be changed by statements in briefs and petitions.

Hence the instant action upon proper allegations.

IV

The respondent has misread the *Koblitz* complaint.

At page 6 of its brief, the respondent says:

> "* * * Its (The Koblitz complaint's) factual allegations were conceded below, and are conceded here (Pet. 5, 8), to be substantially identical with those of the Rieser complaint. * * *"

And at pages 8 and 9 of the respondent's brief, the respondent says:

> "* * * Koblitz concedes that the *Rieser* complaint, and the complaint in the instant action allege exactly the same injury to the same property by reason of the same acts by B & O (Pet. 5). Since Koblitz has not pleaded operative facts different in any way from those pleaded in the *Rieser* action, he has not pleaded a new cause of action."

And at page 8, in attempting to distinguish the *Bogert* case from the instant case, the respondent says:

> "* * * But here, the two claims remain identical in all essential respects. Koblitz in both actions has relied upon the same alleged acts of B & O, all purportedly occurring prior to the Alton reorganization decree (May 31, 1947). In each case Koblitz has sued to recover the same debt (the bonded indebtedness) out of the assets which B & O is alleged wrongfully to have withheld or received prior to 1942 from the Alton * * *."

The respondent is mistaken.

Koblitz makes no such concessions.

And the two actions (the *Rieser* action and the *Koblitz* action) are not identical.

Necessarily the facts which are set forth are those which actually existed.

As this Court said in *Baltimore S.S. Co.* v. *Phillips*, 274 U. S. 316, 321 (1926):

> "A cause of action does not consist of facts, but of the unlawful violation of a right which the facts show. * * * 'The facts are merely the means, and not the end. They do not constitute the cause of action, but they show its existence by making the wrong appear. "The *thing*, therefore, which in contemplation of law as its *cause* becomes a ground of action, is not the group of *facts* alleged in the declaration, bill or indictment, *but the result of these in a legal wrong the existence of which, if true, they conclusively evince.*"' *Chobanian* v. *Washburn Wire Company*, 33 R. I. 289, 302."

In the instant case, the facts as alleged, spell out a direct cause of action by a judgment creditor against a fraudulent grantee for an accounting.

IN CONCLUSION

In the interest of justice, it is respectfully submitted that the petition for a writ of certiorari should be granted, in order that the Alton Bondholders may be allowed to prosecute the cause of action which was awarded to them in the reorganization proceeding of Alton.

Respectfully submitted,

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